New Disbursement Quota Rules Under Bill C-33

MARIA ELENA HOFFSTEIN
Fasken Martineau Dumoulin LLP, Toronto, ON
and
THERESA L.M. MAN
Carters Professional Corporation, Orangeville, ON

Introduction

The disbursement quota is a prescribed amount that registered charities must disburse each year in order to maintain their charitable registration. The purpose of the disbursement quota is "to ensure that most of a charity's funds are used to further its charitable purposes and activities; to discourage charities from accumulating excessive funds; and to keep other expenses at a reasonable level."[1] A good understanding of the disbursement quota rules is important not only for charities, but also for donors and their advisors. An understanding of how charities are legally required to disburse donations is fundamental to a donor's ability to structure gifts that meet the needs of both the donor and the recipient charity. Donors wishing to make donations to a charity through their private foundation will be interested to know the disbursement quota implications of such a gift. Similarly, donors wishing to donate property through the establishment of an endowment will need to be advised as to how best to structure their gifts. The source of the gift, the nature of the proposed recipient charity, the nature of the property gifted, and any restrictions that may be imposed on the gift will all have a bearing on the disbursement quota consequences of the gift.

On March 23, 2004, the Department of Finance released the Federal 2004 Budget (the "March 2004 Budget"), which included significant proposed amendments to the *Income Tax Act* (the "Act")[2] pertaining to the calculation of the disbursement quota. The March 2004 Budget represents a major initiative by the federal government in rewriting the tax rules concerning the taxation and administration of charities and reflects, to a large extent, the proposals of the Voluntary Sector Initiative's Joint Regulatory Table contained in its report of March 2003 "Strengthening Canada's Charitable Sector: Regulatory Reform," particularly as it relates to intermediate taxes and sanctions. In general, these initiatives include changes to the Act in the following areas:

- new intermediate sanctions and related matters, such as the transfer of assets upon revocation of charitable status and new rules regarding the annulment of registered charities;
- prohibitions on trading in charitable donations;

- a new appeal regime for registered charities, including a new internal reconsideration process and the appeal of taxes and penalties to the Tax Court of Canada;
- transparency and accessibility of information concerning registered charities, including release of more information to the public concerning registered charities and organizations that are denied registration, inclusion of more information on official tax receipts, and increased information on Canada Revenue Agency's ("CRA") website; and
- new disbursement quota rules.

Draft amendments to the Act were released on September 16, 2004, to implement the changes announced in the March 2004 Budget, and further amendments were made on December 6, 2004. A Notice of Ways and Means Motion was tabled by the Minister of Finance in the House of Commons in December 2004. The proposed amendments were introduced as Bill C-33,[3] which was enacted on May 13, 2005.[4]

These changes represent the most significant revision of the tax rules affecting charities under the Act in the last twenty years and will affect charities for many years to come. This article focuses on an aspect of these changes, namely the disbursement quota rules. While Bill 33 rectified a number of technical problems regarding the disbursement quota involving charities, it also introduced new concepts and complexities. The first part of this article outlines the disbursement quota rules that were in place prior to Bill C-33. The second part explains the new disbursement quota rules under Bill C-33.

The changes enacted by Bill C-33 are separate and apart from the proposed draft amendments to the Act released on November 9, 2006, by the Department of Finance (the "November 2006 Amendments") that will impact the operations of registered charities in Canada in a substantial way, including split-receipting, designation of charitable organizations and public foundations, and revocation of charitable registrations.[5]

A. Summary of Disbursement Quota Rules Prior to the Amendments

Before examining the new disbursement quota rules under Bill C-33, it is necessary to review the disbursement quota rules that were in place prior to its enactment. The disbursement quota for charitable organizations, public foundations, and private foundations were different.[6] Disbursement quota was defined in subsection 149.1(1) of the Act.[7]

1. Charitable Organizations

Prior to the enactment of Bill C-33, the disbursement quota for a charitable organization was the total of two figures, i.e., variables "A" and "A.1," used in an algebraic formula contained in subsection 149.1(1) of the Act. Variable "A" was

defined as 80% of the total of all amounts for which the charity issued a donation receipt in its immediately preceding taxation year, other than the following:

(a) a gift of capital received by way of bequest or inheritance;

(b) a gift received subject to a trust or direction to the effect that the property given, or property substituted therefor, was to be held by the charity for a period of not less than 10 years (this is commonly known as "ten-year gifts"); and

(c) a gift received from another registered charity.

Variable "A.1" was defined as 80% of the amounts that were (1) gifts that were previously excluded from the charity's disbursement quota when calculating variable "A" above, by virtue of being either (i) capital received by way of bequest or inheritance for taxation years that begin after 1993 or (ii) ten-year gifts whenever they were received, and (2) spent by the charity in the year.

2. Public Foundations

Prior to the enactment of Bill C-33, the disbursement quota for a public foundation was set out in the following formula:

$$A + A.1 + B + \{C \times 0.045 [D - (E + F)]\} \div 365 + G$$ [8]

3. Private Foundations

For a private foundation, the disbursement quota was the same as that for a public foundation prior to the enactment of Bill C-33, except:

(a) When calculating variable "B," 100% of all amounts received from a registered charity in its immediately preceding taxation year were included in the disbursement quota, rather than 80%.

(b) Variable "F" was the same as variable "B" (i.e., 100% of all amounts received from other registered charities in its immediately preceding taxation year) rather than 5/4 of "B" because 100% of the amounts had already been taken into account when calculating variable "B."

4. Summary

Schedule 1 to this article (see pg. 321) summarizes the disbursement quota rules that were in place prior to the enactment of Bill C-33.

B. Disbursement Quota Rules Under Bill C-33

1. New Disbursement Quota Formula

Bill C-33 sets out a new formula for calculating the disbursement quota:

$$A + A.1 + B + B.1$$

Variable "A" deals with gifts for which a charity issued donation receipts in its immediately preceding taxation year. Variable "B" deals with gifts of "enduring property" expended or transferred to another charity in the year. Variable

"B" deals with gifts received from other charities in its immediately preceding taxation year. Variable "B.1"[9] deals with investment assets of the charity. The meaning and implications of the new disbursement quota formula and each of the above-noted variables are commented upon below.

2. Reduction of Disbursement Quota Rate

Prior to the enactment of Bill C-33, public and private foundations were subject to a 4.5% disbursement quota on capital assets not used directly in their charitable activities or administration. Bill C-33 reduced the 4.5% disbursement quota that applies to public and private foundations to a more manageable rate of 3.5%.[10]

Apparently, the formula that was used by the Department of Finance is based on the current real rate of return minus 20% attributable to administrative costs. This is a welcome amendment to the Act because charities have found it difficult to meet the 4.5% disbursement quota when interest rates are low without expending a portion of the capital of the bequest or ten-year gifts. As noted in Appendix 9 of the March 2004 Budget, the 3.5% figure is intended to be "more representative of historical long-term real rates of return earned on the typical investment portfolio held by a registered charity." The March 2004 Budget also indicates that the rate is to be reviewed periodically to ensure that it continues to be representative of long-term rates of return. Unfortunately, this intended flexibility has not been built into the new disbursement quota formula in the Act. This would mean that changes in the economy in future may make the 3.5% disbursement quota percentage unmanageable and would necessitate future amendments to the Act. As such, it is regrettable that Bill C-33 does not provide that the new disbursement quota percentage be prescribed by regulation rather than being written into the Act itself, as this would have accommodated future adjustments more easily

3. Extension of 3.5% Disbursement Quota to Charitable Organizations

Prior to the enactment of Bill C-33, only public and private foundations were subject to the 4.5% disbursement quota on capital assets not used directly in charitable activities or administration. In addition to reducing the 4.5% disbursement quota to 3.5%, Bill C-33 now requires that the reduced 3.5% disbursement quota on capital assets also apply to charitable organizations.[11] The reason for this, as stated in the March 2004 Budget, is that while historically charitable foundations were the primary beneficiaries of endowments, both charitable organizations and foundations today can and do hold capital endowments from which investment income is generated. The Department was concerned that if charitable organizations were not subject to the 3.5% disbursement quota, this investment income would not be subject to any disbursement quota obligation.

For charitable organizations registered after March 22, 2004, the 3.5% disbursement quota now applies to their taxation years that begin after March 22, 2004. For charitable organizations registered before March 23, 2004, the 3.5% disbursement quota will apply to their taxation years that begin after 2008.

With the removal of this key distinction between charitable organizations and foundations, there will be little functional difference between the two. The key remaining differences appear to be that (i) a charitable organization is prohibited from disbursing more than 50% of its annual income to qualified donees unless they are association charities (i.e., it must disburse at least 50% of its annual income on its own charitable activities) and (ii) foundations are restricted in their ability to incur debt.[12] It would not be surprising, therefore, if the Department of Finance, as a matter of policy, eventually eliminates the distinction between charitable organizations and foundations altogether so that there would be only two categories of charities, i.e., charities and private foundations.

4. De Minimus Threshold on the Application of the 3.5% Disbursement Quota

One of the significant changes brought by Bill C-33 is the application of the reduced 3.5% disbursement quota to all registered charities (including charitable organizations) rather than only to charitable foundations as was previously the case. As a result of the application of the 3.5% disbursement quota to charitable organizations, concerns were raised in the charitable sector regarding the ramifications of the application of this requirement on small charitable organizations. In response to this concern, the reduced 3.5% disbursement quota applies to all registered charities (including charitable organizations, public foundations, and private foundations) only if the amount of their investment assets calculated under variable "D" of the disbursement quota formula is greater than $25,000. Where the amount of investment assets is equal to or less than $25,000, variable "D" would be nil.[13] However, despite the Department's attempt to relieve hardship that may be faced by small charitable organizations, there is still concern that the threshold of $25,000 is too low and therefore would not be of assistance to them.

5. New Concept of "Enduring Property"

Bill C-33 introduced a new concept of "enduring property."[14] The definition of "enduring property" is contained in subsection 149.1(1) and means property that is:

(a) a gift received by a charity by way of a bequest or inheritance, including a gift deemed by subsection 118.1(5.2) or (5.3) of the Act;[15]

(b) a gift received by a charitable organization from another registered charity, where the majority of directors and trustees of the donor charity deal at arm's length with the recipient charitable organization, provided that the gift is subject to a trust or direction requiring the gift (or property substituted for the gift) be utilized in its entirety over a period not exceeding five years either (i) to acquire tangible capital property to be used directly in the charitable activities or administration of the charitable organization, (ii) to be used in the course of a program of charitable activities that could not reasonably be completed before the end of the first taxation

year of the charitable organization after the gift was received; or (iii) a combination of the above two options;

(c) a ten-year gift[16] received by a charity (i.e., the "original recipient charity") subject to a trust or direction that the gift, or property substituted for the gift, is to be held by the original recipient charity or by another registered charity (i.e., "transferee") for a period of not less than 10 years from the date the original recipient charity received the gift, except that the trust or direction may permit the original recipient charity or the transferee to expend the property before the end of 10 years to the extent permitted under variable "B.1" of the definition for disbursement quota in order to meet the disbursement quota requirement;[17] or

(d) a gift received by a charity as a transferee of an enduring property under (a) or (c) above from either an original recipient charity or another transferee charity, provided that if it is an enduring property under (c), the gift is subject to the same terms and conditions under the trust or direction.[18]

The new definition applies in respect of taxation years that begin after March 22, 2004. The following are several observations regarding the new concept of "enduring property":

(a) New broad concept
The term "enduring property" is very broad and includes gifts received by way of bequest or inheritance and ten-year gifts that were included in the formula for variable "A" prior to the enactment of Bill C-33, as well as life insurance proceeds, registered retirement income funds and registered retirement savings plans as a result of direct beneficiary designation, gifts received by a charitable organization from another registered charity to be expended in the next five years or less on its charitable activities, and gifts received by the charity as a transferee of an enduring property that are gifts by way of bequest or inheritance and ten-year gifts from either an original recipient charity or another transferee charity, provided that if the gift is a ten-year gift, the gift is subject to the same terms and conditions under the trust or direction.

(b) Gifts by way of bequest or inheritance: income vs. capital
In relation to gifts received by a charity by way of bequest or inheritance, these gifts are no longer limited to "gifts of *capital* received by way of bequests or inheritance" [emphasis added] under the definition of disbursement quota prior to the amendments introduced by Bill C-33.[19] This means that a testamentary income interest received by a charity would now be included as part of an enduring property.

(c) Gifts made by way of direct designation
As a result of amendments to the Act introduced by the 2000 Federal Budget, payments of life insurance proceeds [paragraph 118.1(5.2)], registered retirement income fund or registered retirement savings plan

[paragraph 118.1(5.3)] as a result of direct beneficiary designation were deemed to be gifts for the purposes of section 118.1 in respect of deaths that occur after 1998, provided that the requirements under subsections 118.1(5.1), (5.2) and (5.3) are met. As such, upon the death of an individual, a charitable donation tax receipt could be provided to the estate, and the executor could claim the donation tax credit on the deceased's terminal income tax return. However, CRA's technical interpretation document number 2002-0133545 dated January 16, 2003, confirmed that "these payments would not be deemed to be gifts for purposes other [than] section 118.1, i.e., they would not be considered gifts for purposes [of] calculating the disbursement quota pursuant to the definition in subsection 149.1(1) of the Act and, therefore, would not be included therein."[20]

Bill C-33 addressed this drafting error[21] by including these gifts in the definition of enduring property and, therefore, in the calculation of the disbursement quota. These gifts are now subject only to the 3.5% disbursement quota while they are held as capital by the charity and are subject to the 80% disbursement quota requirement in the year in which they are disbursed. This amendment applies in respect of deaths after 1998; this retroactivity may lead to hardship for charities that had relied on the earlier position of CRA that such direct designations would not be included in the charities' disbursement quota from the enactment of subsections 118.1 (5.1) to (5.3) in 2000 to the present.

(d) "Five-year gifts"
This category of enduring property includes a gift received by a charitable organization from another registered charity to be expended within five years. For purposes of this article, this type of gift is referred to as "five-year gift." It appears that this provision is intended by the Department to provide relief for a charitable organization to cover expenses to be incurred over a number of years. The following requirements apply to five-year gifts:

- A five-year gift must be received by a charitable organization. It cannot be received by either a private or public foundation.
- A five-year gift must be transferred from a registered charity, i.e., either a charitable organization or a charitable foundation. In other words, a five-year gift cannot be made by a donor who is not a registered charity.
- More than 50% of the directors and trustees of the donor charity must deal at arm's length with each of the members of the board of directors or trustees of the recipient charitable organization.
- The donor charity must impose a trust or direction on the gift transferred (or property substituted for the gift), requiring that the gift be held by the recipient charitable organization for not more than five

years and be utilized in its entirety over that period. However, it is not clear what would happen to the disbursement quota of the donee charitable organization if it is not utilized in its entirety over the five-year period.

- The five-year gift may be used for only two purposes, namely either (i) to acquire tangible capital property of the recipient charitable organization to be used directly in its charitable activities or administration, or (ii) to be used in the course of a program of charitable activities that could not reasonably be completed before the end of the first taxation year of the charitable organization after the gift was received, or (iii) a combination of the above two options.

(e) Ten-year gifts subject to ability to encroach
The definition of "enduring property" permits a ten-year gift that is subject to a trust or direction that allows the original recipient charity or the transferee charity to expend the ten-year gift before the end of ten years to the extent permitted under the definition for disbursement quota in order to meet its disbursement quota requirement. Further comments concerning limits on the encroachment are set out below.

(f) Transfer of ten-year gifts
Paragraph (d) of the definition of "enduring property" permits a ten-year gift to be transferred to another registered charity during the hold period as if the ten-year gift had been received directly from the original donor, without the amount transferred affecting the disbursement quota for either the transferor charity or the recipient charity. This is further explained in the section of this article concerning inter-charity transfers.

6. Encroachment on Enduring Property

Prior to Bill C-33, variable "A.1" of the disbursement quota required gifts received by a charity by way of bequest or inheritance or ten-year gifts that had previously been excluded in the calculation of disbursement quota under variable "A" to be included in determining the disbursement quota in the year they were expended. A ten-year gift is "a donation that is made subject to a donor's written trust or direction that the gift be held by a registered charity for 10 years or more."[22] CRA took the position that if all or any portion of the capital of a ten-year gift, or property substituted for it, is expended in a year prior to the expiration of ten-years from the time the gift was given, then the entire ten-year gift, or property substituted for it, *may* be subject to the 80% disbursement quota in that year. The word "may" is used here to denote the fact that the law and the administrative practices of CRA are unclear on this point. It is also unclear from the wording of the new disbursement quota rules whether this difficulty has been addressed.

The March 2004 Budget explained that, since an annual disbursement quota is applied to funds held by charities, sometimes a charity may prefer to (or may be

compelled to) meet its obligation to satisfy the disbursement quota by realizing capital gains rather than and in addition to disbursing investment income earned from these funds, especially where the return on the investment is weighted heavily in favour of capital gains or in a low-interest environment. However, "if the charity does so,… it must also then meet an 80 per cent disbursement obligation to the extent that the proceeds of disposition are expended by the charity."[23] This difficulty is caused by the fact that the 4.5% disbursement quota and the 80% disbursement quota applicable to the portion of a ten-year gift expended in any year are *cumulative* disbursement quota obligations. Under the old rules, when an amount that has been subject of a ten-year gift is encroached on to satisfy the 4.5% disbursement quota, it is also bought into the 80% disbursement quota calculation.[24]

The difficulty caused by the wording in the Act was addressed by including variable "A.1" in the disbursement quota formula. In this regard, variable "A.1" is the sum of 80% of enduring property expended by the charity in the year under subparagraph A.1(a)(i) (except for [1] specified gifts, (2) pre-1994 bequests or inheritances and (3) property described in [ii]) and the full fair market value of enduring property transferred by the charity to a qualified donee under subparagraph A.1(a)(ii). This sum will need to be reduced by the amount claimed by the charity under paragraph A.1(b) that may not exceed the lesser of 3.5% of the investment assets of the charity under variable "D" and the capital gains pool of the charity for the year.[25]

These changes apply to taxation years that begin after March 22, 2004. It is important to note the following in relation to the new definition of variable "A.1":

(a) Capital Gains Pool
The new term "capital gains pool" applies for the purpose of calculating the "disbursement quota" for taxation years that begin after March 22, 2004. The capital gains pool for a taxation year is the total of all capital gains of a charity from the disposition of enduring properties after March 22, 2004, and before the end of the taxation year, as declared by the charity in its T3010 Information Return for the taxation year during which the disposition occurred, that exceeds the lesser of the following two amounts set out in paragraph (b) in the definition for "capital gains pool":

- The amount determined according to subparagraph A.1(a), i.e., the total of 80% of certain enduring property expended by the charity[26] and the full fair market value of enduring property transferred by the charity to a qualified donee other than enduring property that is a specified gift,[27] and
- The amount claimed by the charity according to subparagraph A.1(b), i.e., the amount claimed by the charity that may not exceed the lesser of 3.5% of the charity's investment assets and its capital gains pool.

In summary, the capital gains pool is a notional account of all realized capital gains derived from the investment assets of the charity. However, the capital gains from a disposition of a bequest or inheritance received by the charity before 1994 is not included. A charity may encroach on this capital gains pool to satisfy its 3.5% disbursement quota.

The phrase "an amount claimed by the charity" in subparagraph A.1(b) has the effect of permitting the charity to decide *whether* to encroach on the capital gains pool and, if so, *how much* to encroach. Further, the concept of the "capital gains pool" imposes a cap on charities wishing to encroach on realized capital gains of testamentary gifts and ten-year gifts in order to meet the 3.5% disbursement quota, instead of being able to encroach on the capital up to the amount required to satisfy the 3.5% disbursement quota.

Bill C-33 now contains an explicit provision allowing the encroachment of realized capital gains within certain limits. In this regard, the permitted encroachment under paragraph A.1(b) may not exceed the lesser of 3.5% of the investment assets of the charity under variable "D" and the capital gains pool of the charity. However, it is silent on whether it is permissible for a charity to encroach on the capital of an enduring property. It would appear that should a charity encroach upon the capital of an enduring property (for example, in situations where the realized capital gains pool is not sufficient to satisfy the 3.5% disbursement quota) or the realized capital gain beyond the permitted limit, the amount of the property encroached beyond the permitted limit would be subject to the 80% disbursement quota, leaving the remaining 20% being eligible to satisfy the required 3.5% disbursement quota.

The calculation of the capital gains pool does not appear to be a straightforward exercise. For example:

(i) Realized capital gains
It is important to note that the capital gains pool consists only of capital gains *realized* on the disposition of enduring property. Unrealized capital gains are not included. Since only realized capital gains are included in the capital gains pool, in some circumstances it may be beneficial for a charity to dispose of its investment assets at a time when the market is high in order to maximize the amount of realized capital gains in the pool available for future encroachment when required.

(ii) Notional account
The capital gains pool is a notional account of all realized capital gains derived from the investment assets of the charity. It should be noted, however, that just because amounts are tracked in the notional account of the capital gains pool, this does not necessarily mean that

funds are available for disbursement, especially in situations where there is a loss in the value of an enduring property as a result of a downturn in the market.

(iii) Declaration on T3010
The Bill C-33 introduced a requirement that the total of all realized capital gains of a charity from the disposition of enduring properties must be "declared by the charity" in its T3010 Information Return "for the taxation year during which the disposition occurred." The Explanatory Notes to the proposed amendments indicate that "annual calculation of additions to and deductions from the capital gains pool is voluntary; however, it may be of benefit to a charity to make this calculation if it expects to ever claim a reduction of its disbursement quota in respect of the expenditure of enduring property." In other words, in practice, regardless of whether a charity expects to encroach on its capital gains pool in the year, it should make its annual calculation and declare the amount of all capital gains from the disposition of enduring properties on an annual basis on its T3010 Information Return in order to be able to encroach on its capital gains pool if and when it is required to do so in the future.

(iv) The need to distinguish between income and capital
As can be seen from the definition for the capital gains pool, the calculation of the capital gains pool is not simple. The continuing focus on distinguishing between what is capital and what is income is interesting in the context of charities and disbursement quota calculations. This distinction is well known to trust lawyers and trustees who need to ascertain the respective rights and entitlements of income beneficiaries on the one hand and capital beneficiaries on the other hand, but there would appear to be no reason to make such a distinction in the charity area and in particular in the monitoring of charitable expenditures. Furthermore, the distinction between income and capital is difficult for charities to understand and is therefore often ignored. New investment vehicles such as mutual funds which provide blended income and capital payments do not lend themselves easily to determining what is income and what is capital and as such, the tracking of the capital gains pool by charities may prove to be challenging for charities to comply with if they take advantage of the intended relief offered by the capital gains pool under the new rules.

(b) Exclusion of certain enduring property
When calculating variable "A.1," the following enduring properties are not included:

(i) enduring properties included in paragraph (a)(ii) in the definition for "A.1";

(ii) enduring properties received by the charity as "specified gifts," and

(iii) a bequest or an inheritance received by the charity in a taxation year that included any time before 1994.

The above exceptions in relation to enduring properties included in paragraph (a)(ii) in the definition for "A.1" and "specified gifts" are commented upon below concerning inter-charity transfers.

(c) Gifts received and spent in the same year
Prior to Bill C-33, long-term gifts (i.e., ten-year gifts and gifts received by way of bequest or inheritance) were subject to an 80% disbursement quota to the extent that the registered charity liquidates and spends the capital in a year following the year in which the gift is received. However, these rules did not address the situation where the charity receives a long-term gift and disburses it in the same year. In Bill C-33, this loop-hole was eliminated by removing the requirement under the calculation of variable "A.1" for gifts that have previously been excluded from the charity's disbursement quota. As such, the 80% disbursement quota rule applies to gifts that are expended in the same year that they are received.

7. Inter-Charity Transfers Involving Enduring Property That Are Not Five-Year Gifts

The inter-charity transfer provision contained in paragraph (d) of the definition of enduring property is only applicable to gifts by way of bequest or inheritance and ten-year gifts, and does not apply to five-year gifts set out in paragraph (b) of the definition. This section of the article first deals with inter-charity transfers under paragraph (d). Inter-charity transfers involving five-year gifts will be discussed in the next section.

(a) Gifts transferred to charitable organizations
Prior to Bill C-33, only transfers from registered charities to public and private foundations were subject to the 80% disbursement quota, which meant that transfers from registered charities to charitable organizations were exempt from the 80% disbursement quota. Bill C-33 now requires all transfers from one registered charity to another, including transfers to charitable organizations, be subject to the 80% disbursement requirement.

The only exceptions are transfers involving specified gifts and enduring property.[28] Thus gifts of enduring property received from another registered charity are no longer subject to the disbursement quota of the recipient charity in the year after the year in which it is received. Such gifts are subject to the same requirements as those that apply to gifts of enduring property received from other persons. The exception for a "specified gift"

will continue to apply. These changes apply to transfers received by charitable organizations in taxation years that begin after March 22, 2004.

(b) Three categories of property transfers
Under the new disbursement quota rules, there are three categories of transfer of property between charities, namely specified gifts, enduring property (that has not been designated as specified gifts by the transferor charity) and other gifts that are neither enduring property nor specified gifts (which in the context of this article are referred to as "ordinary gifts"[29]). The impact of each of the three categories of transfers on the disbursement quota of the both the transferor charity and the transferee charity is explained below.

(c) Transfer of ordinary gifts
Under the new disbursement quota rules, a gift may be transferred as an "ordinary gift" between two charities. An ordinary gift is a gift of property that the transferor charity does not designate as a specified gift and where the property is not an enduring property as defined in 149.1(1) of the Act. Pursuant to the new disbursement quota rules, the transferor charity would be able to utilize the transfer of the ordinary gift to satisfy its disbursement quota obligation in the taxation year in which the transfer is made. With respect to the transferee charity, the receipt of the ordinary gift would create a disbursement quota obligation under variable "B" of the disbursement quota formula. If the transferee charity is either a charitable organization or a public foundation, the transferee charity would be required to expend in the following taxation year 80% of the ordinary gift received. If the transferee charity is a private foundation, the transferee charity would be required to expend in the following year 100% of the ordinary gift received. [See Schedule 2, pg. 322]

(d) Transfer of specified gifts
A "specified gift" is defined under subsection 149.1(1) of the Act as "that portion of a gift, made in a taxation year by a registered charity that is designated as a specified gift in its information return for the year." CRA's Policy CSP – S12 dated September 3, 2003, indicates that a specified gift is "a gift from one registered charity to another, where the charities involved choose to make the transfer without affecting the disbursement quota of either charity." A gift becomes a specified gift if the transferor charity identifies it as such in its information return for the year.

Under the new disbursement quota rules, a transferor charity that designates a gift to another charity as a specified gift is not permitted to utilize the transfer of the specified gift to satisfy its disbursement quota obligation for the year because a specified gift is deemed not to be an expenditure on charitable activities or a gift made to a qualified donee pursuant to paragraph 149.1(1.1)(a) of the Act and therefore is not included when calculating a charity's disbursement quota obligation. With respect to the

transferee charity, the transfer does not create any disbursement quota obligation because specified gifts are excluded under variables "A.1" and "B" of the disbursement quota formula. When the transferee charity subsequently expends the specified gift it received, it would be able to utilize the expenditure of the specified gift to satisfy its disbursement quota obligation. [See Schedule 3, page 323]

(e) Transfer of enduring property

As noted above, Bill C-33 introduced a new concept of "enduring property." Due to a drafting error in the definition of the disbursement quota in the Act prior to Bill C-33, if a charity transferred a ten-year gift to another charity, the transferee charity had to expend 80% of the ten-year gift in the year following the transfer. In order to avoid this result, the recipient charity would be required to recognize the amount received as a specified gift. However, in order for the amount transferred to be recognized as a specified gift, the amount had to be designated as such by the transferor charity. The disposition of the property as a specified gift by the transferor charity means that the transferor charity was not permitted to include the amount transferred in meeting its disbursement quota obligation created by the transfer itself. To overcome this difficulty, the transferor charity or the transferee charity would have to seek relief from CRA by applying for dispensation from the application of the disbursement quota under subsection 149.1(5) of the Act.

In order to address this anomaly, the transfer of enduring property is not included in variable "B." The effect of this would be that a gift of enduring property received by a charity would not need to be included in the disbursement quota of the transferee charity and thus would not need to be expended in the following year by the transferee charity. With respect to the transferor charity, subparagraph A.1(a)(ii) includes the fair market value of enduring property transferred by the charity in the year by way of a gift to a qualified donee (which does not include enduring property that was received by the charity as a specified gift). In addition, the effect of this amendment also meant that this amount would be eligible for capital gains reduction claimed under A.1(b). In this regard, the Explanatory Notes indicate that a different disbursement requirement applies for an enduring property that is expended by way of a gift to a qualified donee. The charity must disburse 100% of such an amount (which requirement is satisfied by the gift itself). This means that the transferor charity would be able to include the amount of enduring property it transfers to a qualified donee in order to meet its disbursement quota obligation, which would offset the increase in disbursement quota of the transferor charity as a result of disposing of the enduring property to the qualified donee. This amendment applies to taxation years after March 22, 2004.

Under the new disbursement quota rules, when a charity transfers an enduring property to another charity (and does not designate the enduring property as a specified gift), the transfer would create a disbursement quota obligation on the transferor charity to expend 100% of the value of the property in the year of the transfer under variable "A.1(a)(ii)" of the disbursement quota formula. This disbursement quota obligation on the transferor charity would be satisfied by the transfer itself, i.e., the transferor charity would include this transfer in satisfying its disbursement quota obligation for the year. With respect to the transferee charity, the receipt of the enduring property would not create a disbursement quota obligation on the charity because enduring property is not included in variable "B" in the disbursement quota formula. Upon the subsequent expenditure of the enduring property by the transferee charity, the expenditure will create a disbursement quota obligation on the charity so that it is required to expend 80% of the enduring property in the year under variable "A.1(a)(i)" of the disbursement quota formula. The expenditure itself would be utilized to satisfy the disbursement quota obligation of the charity in the year. [See Schedule 4, pg. 324]

If the enduring property being transferred was designated by the transferor charity, either inadvertently or purposefully, as a specified gift, such a designation would not cause any negative effect on the disbursement quota of the transferee charity.[30] However, the transfer itself would create a disbursement quota obligation on the transferor charity in the year of the transfer.[31] However, the transferor charity would not be able to use the transfer itself to satisfy the disbursement quota obligation (including the disbursement quota obligation created by this transfer) because it is transferred as a specified gift.[32] This means that the transferor charity would need to spend other funds to satisfy both the disbursement quota obligation created by this transfer and its other disbursement quota obligations.

The effect of these rules is that there does not appear to be any reason for the transferor charity to transfer an enduring property as a specified gift; in fact, it may be dangerous to do so for the transferor charity. The situation where a transferor charity may agree to designate a gift of enduring property to another charity as a specified gift is where the transferor charity has sufficient disbursement excess from previous year(s) that it could utilize to satisfy the disbursement quota obligation created by such a transfer and there may be some benefit to the recipient charity on receiving the gift as a specified gift so that the transfer would not ever impact its disbursement quota obligation. [See Schedule 5, pg. 325]

(f) Factors to consider in determining how to categorize inter-charity transfers

Since different categories of transfer impact on the disbursement quota obligation and disbursement quota satisfaction of the transferor charity

and the transferee charity differently, in determining how to categorize a transfer of assets from one charity to another charity, the following questions would need to be asked by the transferor charity:

Question (1) Is the property an enduring property?

Question (2) Does the transferor charity require the disbursement to satisfy its disbursement quota obligation for the year and/or disbursement quota shortfall from prior years?

If the answer to question (1) above is "no," and if the answer to question (2) is "yes," then the transferor charity would want to transfer the property as an ordinary gift, not as a specified gift, in order to be able to utilize the transfer to satisfy its disbursement quota obligation. However, the transferee charity would need to include the transfer in its disbursement quota obligation for the following year. If, however, the transferor charity transfers the property as a specified gift, the transferor charity cannot use the transfer to satisfy its disbursement quota obligation for the year and the transfer does not create any disbursement quota obligation for the transferee charity.

If the answers to both questions (1) and (2) above are "no," then the transferor charity may choose to transfer the property either as an ordinary gift or as a specified gift. If the property is transferred as an ordinary gift, and since the transferor charity does not need to include the transfer in order to satisfy its disbursement quota obligation for the year, the transfer will lead to a disbursement quota excess for the transferor charity for use in future years. The transferee charity would need to include the transfer in its disbursement quota obligation for the following year. If the property is transferred as a specified gift, the transferor charity cannot use the transfer to satisfy its disbursement quota obligation for the year, which is not problematic for the transferor charity since its response to (2) is "no." The transfer would not create any disbursement quota obligation for the transferee charity.

If the answer to question (1) above is "yes" and if the transferor charity transfers the enduring property to the transferee charity, the transfer would create a disbursement quota obligation on the transferor charity, which will be satisfied by the transfer itself. If the answer to question (2) is "yes," the transfer would not be of benefit to the transferor charity in relation to the satisfaction of its other disbursement quota obligation because the transfer would be utilized to satisfy the disbursement quota obligation by the transfer itself. In relation to the transferee charity, the transfer would not affect its disbursement quota obligation until it is expended by the transferee charity.

If the answer to question (1) above is "yes" and if the transferor charity transfers the enduring property as a specified gift to the transferee char-

ity, the transfer itself would create a disbursement quota obligation on the transferor charity in the year of the transfer and the transferor charity would not be able to use the transfer itself to satisfy the disbursement quota obligation created by this transfer or any other disbursement quota obligation of the transferor charity (i.e., if the answer to question (2) is "yes"). This means that the transferor charity would need to use other expenditure in the year to satisfy both the disbursement quota obligation created by this transfer and its other disbursement quota obligation. The transfer does not create any disbursement quota obligation for the transferee charity.

(g) Transfer as a result of penalty
Subsection 149.1(1.1) of the Act provides that a gift or expenditure made by a registered charity would not be considered in determining whether it has met its annual disbursement quota if the gift is made by way of a specified gift or if the expenditure is on political activities.[33] New subparagraph 149.1(1.1)(c) provides that a transfer to another registered charity under that Part does not qualify as an expenditure for the purposes of calculating the transferor's disbursement quota. This amendment applies in respect of notices of intention to revoke the registration of a charity and to notices of assessment issued by the Minister after the day that is 30 days after Royal Assent.

8. Inter-Charity Transfers Involving Five-Year Gifts

Inter-charity transfers involving five-year gifts under paragraph (b) of the definition of enduring property are treated differently from inter-charity transfers of other types of enduring property under paragraph (d) of the definition. This section of the article includes brief comments regarding the transfer of five-year gifts between charities.

If a donor transfers a property to a charitable organization to be expended on the charity's program, it cannot qualify as a five-year gift because such gifts can only be created when property is transferred from a registered charity to a charitable organization. A donor who is not a registered charity cannot create such a gift.

If a donor charity transfers property to a charitable organization to be used for its fundraising expenses over a five-year period, such a gift would also not qualify as a five-year gift. This is because a five-year gift could only be used in the transferee charitable organization's charitable program or administration or be used to acquire tangible capital property to be used in its charitable program. Fundraising expenses do not qualify for these expenses.

If a donor charity A transfers unrestricted property to a charitable organization B that deals at arm's length with charity A to be used for charity B's charitable program to be conducted over five years, this transfer would qualify as a five-year gift. For the transferor charity A, the disbursement of the property would allow charity A to meet its disbursement quota as charity A would not have disposed

of an enduring property. Charity B, however, will have received an enduring property. Therefore the receipt of the five-year gift does not create a disbursement quota obligation for charity A in the year when the property was received. Rather, when charity B disposes of the property in the following five years, the expenditure will create a disbursement quota obligation on charity B so that it is required to expend 80% of the enduring property in the same year under variable "A.1(a)(i)" of the disbursement quota formula. The expenditure itself would be utilized to satisfy the disbursement quota obligation of charity B in the year it is expected.

9. Summary of Other Issues Involving Disbursement Quota[34]

In addition to the new disbursement quota rules enacted by Bill C-33, the following is a summary of some of the more common questions regarding disbursement quotas.

(a) What expenditures count towards satisfying the disbursement quota?
Neither the Act nor the *Income Tax Regulations* contain a provision that expressly deals with how a registered charity may satisfy its disbursement quota under subsection 149.1(1) of the Act. However, this issue is indirectly dealt with by paragraphs 149.1(2)(b), 149.1(3)(b) and 149.1(4)(b) of the Act, which provide that a registered charity may have its charitable registration revoked where it "fails to expend in any taxation year, on charitable activities carried on by it and by way of a gifts made to qualified donees, amounts the total of which is at least equal to the [organization's/foundation's] disbursement quota for the year."

A registered charity's disbursement quota may be satisfied in two ways: (1) by expending amounts by way of gift to qualified donees; and (2) by expending amounts on charitable activities carried on by it.

(i) Qualified donees
Subsection 149.1(1) of the Act provides that qualified donees are entities that can issue official donation receipts for gifts from individuals and corporations.[35] They consist of the following:

- registered charities in Canada;
- registered Canadian amateur athletic associations;
- registered national arts service organizations;[36]
- housing corporations resident in Canada constituted exclusively to provide low-cost housing for the aged;
- Canadian municipalities;
- the United Nations and its agencies;
- universities outside Canada listed in Schedule VIII of the *Income Tax Regulations*;

- charitable organizations outside Canada to which Her Majesty in right of Canada (the federal government or its agents) has made a gift during the fiscal period or in the 12 months immediately preceding the period; and
- Her Majesty in right of Canada or a province (that is, the federal government, a provincial government, or their agencies).

On February 27, 2004, the list of "qualified donees" was expanded to include municipal or public bodies performing a function of government in Canada.[37]

The disbursement of monies to any of these organizations will count towards satisfaction of the disbursement quota.[38]

(ii) Charitable activities
CRA will consider money to be spent directly on charitable activities when its expenditure is essential to providing the charitable program. This includes the salaries of persons performing, or assisting in the performance of, actual charitable work and disbursements for equipment used in charitable activities. It does not include amounts spent on management, general administration, and fundraising.[39]

Money spent on "deemed charitable activities" will not count towards the disbursement quota in all instances. The Act deems money spent by a registered charity on certain political activities to be money spent by that charity in furtherance of its charitable purposes.[40] Nevertheless, the Act provides elsewhere that such expenditures do not count towards the charity's disbursement quota.[41]

(b) Once the disbursement quota has been met, can a registered charity disburse funds to another charity that does not constitute a qualified donee? Charitable organizations are required to devote all of their resources to charitable activities carried on by the organization itself.[42] With respect to charitable foundations, the Act does not specifically contemplate how it may disburse funds *after* it has met its disbursement quota for the year. The Act requires that charitable foundations be "constituted and operated exclusively for charitable purposes."[43] In turn, the Act defines "charitable purposes" as merely *including* the disbursement of funds to qualified donees.[44] In other words, the Act does not *restrict* the definition of "charitable purposes" to the disbursement of funds to qualified donees or to the performance of charitable activities directly by a charitable foundation. Subject to the comments below, it would therefore seem that once a public foundation has met its disbursement quota for the year (which, as indicated above, requires that the prescribed amount be spent directly on charitable activities or indirectly through gifts to qualified donees), it is free to disburse funds to charities that do not constitute qualified donees.

This practice was approved of by CRA several years ago, but CRA later reversed its position on this issue[45] and now takes the position that neither charitable organizations nor foundations may disburse funds to a charity that is a non-qualified donee even if (i) the donor charity's disbursement quota is met and (ii) the donee constitutes a charity at common law. In December 2002, subsections 149.1(2), (3), and (4) were proposed to be amended to provide that gifts made by a charity to a non-qualified donee would become cause for revocation of the charitable status of the charity.[46]

(c) What happens if the disbursement quota is exceeded in a particular taxation year?
There will be a disbursement excess for a particular year where all amounts expended by a charity on charitable activities carried on by it or by way of gifts to qualified donees (but not including specified gifts or expenditures on political activities) exceed its disbursement quota for the year.

A charity can employ a disbursement excess in one of two ways:[47]

(i) The disbursement excess can be applied against a disbursement shortfall occurring in the immediately preceding taxation year; or

(ii) The disbursement excess can be drawn on for up to five subsequent taxation years to help the charity meet its disbursement quota in those years. The excess expenditures need not be evenly spread over the five years. That portion of a disbursement excess used in one year cannot be used in any of the remaining carryover years.

(d) What happens if the disbursement quota is not met in a particular taxation year?
The Act provides that a charity may have its charitable registration revoked for failure to meet its disbursement quota in a particular year.[48] In practice, however, de-registration is not likely to occur unless there have been continuous failures to meet the disbursement quota.

Apart from de-registration, the Act provides two ways of dealing with disbursement shortfalls:

First, as indicated above, disbursement excesses from the preceding five taxation years and/or from the immediately subsequent taxation year may be applied against disbursement shortfalls. (The fact alone that the Act contemplates that a disbursement shortfall in one year may be offset by a disbursement excess from the *subsequent* year is suggestive that deregistration should not result from a single failure to meet the disbursement quota.)

Second, a charity may apply to have its disbursement quota reduced for the particular taxation year.[49] This requires that the charity make an application in prescribed form (Form T2094[50]). Such an application will be

successful only if (i) the charity has used its disbursement excess from prior years and (ii) the disbursement shortfall is due to extraordinary circumstances beyond the charity's control.[51] Moreover, such a relief would only be granted for the purpose of allowing a charity to correct a deficiency in meeting its disbursement quota and would not be granted for an indefinite period.[52]

(e) How can a charity accumulate funds for large-scale projects and still meet its disbursement quota?
It is indicated above that one of the objectives of the disbursement quota is to prevent charities from accumulating excessive funds. One negative consequence of this is that meeting its disbursement quota can prevent a charity from accumulating sufficient funds to make major purchases out of cash and to thereby escape the interest costs associated with financing such purchases. There are, however, two basic methods whereby a charity may accumulate property for large-scale projects[53] without running the risk of disbursement shortfalls:

(i) It may apply under subsection 149.1(8) of the Act for permission to accumulate property. (There is no specific application form.) The application must specify the purpose for which the charity wants to accumulate property, the amount required to be accumulated, and the length of time over which the charity will need to accumulate the property.

If the application is approved, then the amount of the property accumulated during each year of the accumulation period, including the income earned on this property, will count towards the charity's disbursement quota in each year. The ultimate expenditure of the accumulated funds at the end of the accumulation period will have no impact on the disbursement quota in the year of expenditure. (This is to avoid having the same funds counted twice towards satisfaction of the disbursement quota.)

If the application is approved and the accumulated property is not used for the specified purpose within the required time, then subsection 149.(9) of the Act requires that the accumulated property, including the income earned on it, be included in the charity's income as receipted income. The timing of this will be the earlier of (i) the expiration of the accumulation period or (ii) the time at which the charity decided not to use the property for the specified purpose. This will increase the disbursement quota requirement for the following taxation year.

(ii) It can encourage its donors to donate enduring property to the charity, including gifts by way of bequest or inheritance or ten-year gifts. Charitable organizations can also encourage transfers from other

registered charities to make "five-year" gifts. The disbursement quota consequences of enduring property are discussed elsewhere in this article.

Of these two methods of accumulating property for large-scale projects, the most preferable method *may* be to obtain permission to accumulate property under subsection 149.1(8) of the Act. This is because, unlike the accumulation of enduring property, the accumulation of funds under subsection 149.1(8) will, as indicated above, count towards fulfillment of the charity's disbursement quota in each year of the accumulation period.

(f) How will the re-designation of a charity impact its disbursement quota? Charities are designated as charitable organizations, public foundations, or private foundations. As was indicated above, prior to the enactment of Bill C-33, the disbursement quotas were different for these three categories of charities. After the enactment of Bill C-33, under the new disbursement rules, the disbursement quota rules for charitable organizations and public foundation are the same. The happening of any event that results in a charity being re-designated from charitable organizations or public foundations to private foundations and *vice versa* will therefore alter the disbursement quota of that charity.

A re-designation may be brought about in two ways: (i) The Minister of National Revenue may exercise his/her discretion under subsection 149.1(6.3) of the Act to re-designate a charity; or (ii) the charity may itself request that it be re-designated by submitting a completed Form T2095, *Registered Charities: Application for Re-designation*.[54]

A charity's designation as a charitable organization, public foundation, or private foundation is based mainly on the following variables:[55]

- Source of funding and composition of board – For charitable organizations and public foundations, the Act currently provides that more than 50% of directors or trustees must deal with each other at arm's length, and not more than 50% of the capital may be contributed by one person or a group who do not deal with each other at arm's length. Due to requests from the public, the definitions of charitable organizations and public foundations are proposed to be amended to permit a donor to contribute more than 50% of the charity's capital as long as the donor does not control the charity or represent more than 50% of the directors or trustees of the charity.[56] The definition of private foundations remains unchanged, i.e., it is not a requirement that more than 50% of the directors or trustees of a private foundation be at arm's length, and it is not a requirement that not more than 50% of funds received be from one donor or donors who are at arm's length.

- Disbursement of income – Charitable organizations may not disburse more than 50% of their income annually to qualified donees,[57] unless they are associated charities.[58] Public foundations, however, must give more than 50% of their income annually to other qualified donees.[59] Private foundations may give funds to other qualified donees. It is not clear from the Act whether there is any requirement on private foundations to give more than 50% of their income annually to other qualified donees.[60]
- Form of organization – Charitable organizations can be organized either as corporations, unincorporated associations established by constitution, or charitable trusts. [61] Public and private foundations must either be corporations or trusts.[62]
- Related business – Charitable organizations[63] and public foundations can carry on related businesses.[64] Private foundations, however, may not carry on any business activity; otherwise, their charitable status may be revoked.[65]
- Borrowing – Public and private foundations are prohibited from incurring debts other than debts for current operating expenses, the purchase and sale of investments, or the administration of the charitable activities.[66] However, these restrictions do not apply to charitable organizations.
- Control of other corporations – Public and private foundations are prohibited from acquiring control of any corporation.[67] Generally, control occurs when the foundation owns 50% or more of a corporation's issued share capital, having full voting rights under all circumstances.[68] However, a foundation that has not bought more than 5% of these shares but is given a bloc of shares that brings up its total holding to more than 50% will not be considered to have acquired control of the corporation.[69] The restrictions that apply to foundations do not apply to charitable organizations.[70]

A charity must keep these variables in mind so as to avoid inadvertently taking any action that could result in its being re-designated and thereby subjected to a new, potentially more onerous disbursement quota. This could be the case, for example, if a public foundation took any action that could result in it being re-designated as a private foundation. This would result if the public foundation elected board members more than 50% of whom do not deal at arm's length with each other or if it repeatedly accepted very large gifts from a single donor or group of donors that do not deal at arm's length with one another and with more than 50% of each trustee, director, officer, or similar official.

10. Summary of the New Disbursement Quota Rules

Table 1 (see pg. 318) summarizes the calculation of the disbursement quota in order to assist charities and their advisors in developing a better understanding of the new rules.

Conclusion

The above is a summary of the new disbursement quota rules for charities. Although many aspects of the new rules reflect a bona fide attempt by the Department of Finance to address a number of problems facing charities involving the disbursement quota, the complexities introduced by the new disbursement quota rules are such as to make them difficult, if not impossible, for the average charity to understand, let alone comply with. Even with a detailed Disbursement Quota Worksheet for the Registered Charity Information Return - T3010A to assist in the annual calculation of the disbursement quota, charities will still be left in a vulnerable position. This is because charities not only need to be able to compute the disbursement quota at their fiscal year end for purposes of completing their T3010A, but they also need to have a good working knowledge of the computation of the disbursement quota that they are required to satisfy in order to enable them to make informed decisions when planning their receipt and disbursement of funds throughout the year so that their decisions will not negatively impact their ability to meet their disbursement quota requirements.

In addition, there are concerns about the application of the reduced 3.5% disbursement quota being extended from charitable foundations to charitable organizations and the removal of the exemption of transfers of capital to charitable organizations from other registered charities. This is a major change in tax policy by the Department of Finance that would blur the line between public foundations and charitable organizations to the point that the need for the separate category of public foundations may be eliminated all together, leaving only charitable organizations and private foundations. The new disbursement rules are very complex and may leave many registered charities, as well as their advisors, confused about how to implement the new provisions on both a day-to-day basis and in completing their T3010 Information Returns.

Table 1: Calculation of Disbursement Quota Under Bill C-33

Registered Charities	New Disbursement Quota = A + A.1 + B + B.1			
	"A"	"A.1"	"B"	"B.1"
Charitable Organizations and Public Foundations	80% of all eligible amount of gifts for which the charity issued donation receipts in its immediately preceding taxation year, other than: (a) gifts of enduring property; (b) gifts received from other registered charities. "Enduring properties" include properties that are: (a) gifts of bequest or inheritance, including life insurance proceeds, RRSPs, and RRIFs by direct beneficiary designation (b) gifts received by a charitable organization from another registered charity, where the majority of directors and trustees of the donor charity deal at arm's length with the recipient charitable organization, provided that the gift is	The amount by which (a) the total of (i) 80% of the amount by which the total amount of enduring property owned by the charity to the extent that they are expended in the year, and (ii) the fair market value (at the time of the transfer) of enduring property (other than enduring property that was received by the charity as a specified gift) transferred by the charity in the taxation year by way of gift to qualified donees exceeds (b) the amount claimed by the charity that may not exceed the lesser of (i) 3.5% of the amount determined for "D" and	80% of all amounts received from other registered charities in its immediately preceding taxation year, other than specified gifts and enduring property	B.1 = C x 0.035 [D – (E + F)]/ 365 "C" = number of days in the taxation year "D" = (a) average value of the charity's assets in the 24 months immediately preceding the taxation year that were not used directly in charitable activities or administration of the charity, if that amount is greater than $25,000 (b) in any other case, it is nil "E" = "A.1"(a)(ii) + 5/4 of ("A" + "A.1"(a)(i)) "F" = 5/4 of "B" which is = 100% of all amounts received from registered charities in its immediately preceding taxation year
Contiued on next page.				

Registered Charities	New Disbursement Quota = A + A.1 + B + B.1			
	"A"	"A.1"	"B"	"B.1"
Charitable Organizations and Public Foundations (cont'd)	subject to a trust or direction requiring that the gift be utilized over a period not exceeding five years to acquire tangible capital property to be used directly in its charitable activities or administration, or to be used in the course of a program of charitable activities that could not reasonably be completed within one year after having received the gift (Note that this paragraph does not apply to gifts received by public foundations) (c) ten-year gifts (d) gifts received by the charity as a transferee of enduring property that are gifts of bequest or inheritance and ten-year gifts from either an original recipient charity or another transferee charity, provided that if the gifts are ten-year gifts, the gifts are subject to the same terms and conditions under the trust or direction	(ii) the capital gains pool of the charity for the taxation year (defined in the note to the table) NOTE: "Enduring property" not included in subparagraph (a)(i) of "A.1" = (a) enduring properties described in subparagraph (a)(ii) of "A.1" ; (b) enduring properties received by the charity as "specified gifts"; and (c) bequests or inheritance received by the charity in a taxation year that included any time before 1994		
Continued on next page.				

Registered Charities	New Disbursement Quota = A + A.1 + B + B.1			
	"A"	"A.1"	"B"	"B.1"
Private Foundations	same as above	same as above	Same as above, except 100%, rather than 80%	Same as above, except that "F" = "B", not 5/4 of "B"

NOTE: "Capital gains pool" of a registered charity for a taxation year = the total of all capital gains of the charity from the disposition of enduring properties after March 22, 2004, that are declared by the charity in its T3010 Information Return for the taxation year during which the disposition occurred, that exceeds the lesser of the following two amounts:

• The amount determined according to paragraph (a) of variable "A.1," i.e., the total of 80% of enduring property expended by the charity under subparagraph (a)(i) and the full fair market value of enduring property transferred by the charity to a qualified donee under subparagraph (a)(ii).

• The amount claimed by the charity according to paragraph (b) of variable "A.1," i.e., the amount claimed by the charity that may not exceed the lesser of 3.5% of the charity's investment assets and its capital gains pool.

However, the capital gain from the disposition of a bequest or inheritance received by the charity before 1994 is not included.

SCHEDULE 1

Calculation of Disbursement Quota under the Rules Prior to Bill C-33

Registered Charities	Disbursement Quota = A + A.1 + B + {C x 0.045 [D – (E + F)]}÷365 + G			
	"A"	"A.1"	"B"	{C x 4.5% [D – (E + F)]}÷365
Charitable Organizations	80% of the all amounts for which the charity issued a donation receipt in its immediately preceding taxation year, other than: (a) a gift of capital received by way of bequest or inheritance; (b) a ten-year gift; and (c) a gift received from another registered charity	80% of the amounts that are (1) gifts of (i) capital received by way of bequests or inheritance for taxation years that begin after 1993 and (ii) ten-year gifts whenever received, (2) have previously been excluded from the charity's disbursement quota when calculating "A", and (3) are spent by the charity in the year	N/A	N/A
Public Foundations	same as above	same as above	80% of all amounts received from other registered charities in its immediately preceding taxation year, other than specified gifts	4.5% of ["D" - "E" – "F"] "D" = average value of assets of the foundation in the immediately preceding 24 months that were not used directly in charitable activities or administration of the foundation "E" = 5/4 of ("A" + "A.1") = 100% of ("A" + "A.1") "F" = 5/4 of "B" = 100% of all amounts received from registered charities in its immediately preceding taxation year, other than specified gift
Private Foundations	same as above	same as above	Same as above, except 100%, rather than 80%	Same as above, except that "F" = "B", not 5/4 of "B"

SCHEDULE 2

Transfer of an ordinary gift between charities

Ordinary gifts (i.e., not specified gift, not enduring property)	Transferor charity		Transferee charity	
	DQ obligation	DQ satisfaction	DQ obligation	DQ satisfaction
Ordinary gift $100 Charity A → Charity B in year 1	N/A	$100 expended can be used to satisfy DQ obligation of Charity A in year 1	• If Charity B is either a charitable organization or a public foundation: has to expend $80 in year 2 • If Charity B is a private foundation: has to expend $100 in year 2 (i.e.,"B" in DQ formula)	N/A
When Charity B spends the $100 in year 2	N/A	N/A	N/A	$100 expended can be used to satisfy DQ obligation in year 2 (must expend at least $80 of the $100f for a charitable organization or a public foundation and $100 for a private foundation)

SCHEDULE 3

Transfer of a specified gift between charities.

Specified gifts (includes enduring property received as specified gifts)	Transferor charity		Transferee charity	
	DQ obligation	DQ satisfaction	DQ obligation	DQ satisfaction
Specified gift $100 Charity A → Charity B in year 1	N/A	— Charity A cannot use the $100 to satisfy its DQ obligation in year 1 (b/c 149.1(1.1)(a) exclusion of specified gifts)	— Charity B is not obligated to expend any of the $100 in year 2 (b/c specified gifts are excluded from A.1 and B of DQ formula)	N/A
When Charity B spends the $100 in a subsequent year	N/A	N/A	N/A	$100 expended can be used to satisfy DQ obligation in the year when the gift is expended

SCHEDULE 4

Transfer of an enduring property between charities

Enduring property	Transferor charity		Transferee charity	
	DQ obligation	DQ satisfaction	DQ obligation	DQ satisfaction
Enduring property $100 Charity A → Charity B (provided that the property was not received as a specified gift)	Charity A will be required to expend 100% of the fmv of the enduring property (i.e. $100 in this case) in year 1 under A.1(a)(ii) in DQ formula,	$100 expended can be used to satisfy DQ obligation in year 1 (which would in and of itself satisfy the DQ obligation created by making the gift under A.1(a)(ii) in DQ formula	— no effect on DQ (b/c EP is exempt from B in DQ formula)	— no effect on DQ until such time as Charity B expends the gift
	Net effect = DQ neutral for transferor charity			
When Charity B expends the $100 in a subsequent year	N/A	N/A	When Charity B expends the gift in a subsequent year, Charity B will be required to expend at least $80 in the year when the gift is expended (i.e., A.1(a)(i) in DQ formula)	$100 expended can be used to satisfy the DQ obligation in the year when the gift is expended (which would in and of itself satisfy the DQ obligation created by making the gift under A.1(a)(i) 2), in DQ formula (must expend at least $80 of the $100)

SCHEDULE 5

Transfer of an enduring property designated as a specified gift between charities

<table>
<tr><td rowspan="2">Enduring property</td><td colspan="2">Transferor charity</td><td colspan="2">Transferee charity</td></tr>
<tr><td>DQ obligation</td><td>DQ satisfaction</td><td>DQ obligation</td><td>DQ satisfaction</td></tr>
<tr><td rowspan="2">Enduring property $100

If Charity A → Charity B but Charity A designates it as specified gift</td><td>Charity A will be required to expend $100 in year 1 under A.1(a)(ii) in DQ formula</td><td>—

Charity A cannot use the $100 to satisfy its DQ obligation in year 1 (b/c 149.1(1.1)(a) exclusion of specified gifts)</td><td rowspan="2">—

Charity B is not obligated to expend any of the $100 in year 2

(b/c specified gifts are excluded from A.1 and B of DQ formula)</td><td rowspan="2">N/A</td></tr>
<tr><td colspan="2">By designating the transfer as a specified gift, Charity A will have to meet the A.1 DQ obligation created by this transfer with other expenditure</td></tr>
<tr><td>When Charity B spends the $100 in a subsequent year</td><td>N/A</td><td>N/A</td><td>N/A</td><td>$100 expended can be used to satisfy DQ obligation in the year when the gift is expended</td></tr>
</table>

NOTES

1. See Canada Revenue Agency, *Information Circular* RC 4108, "Registered Charities and the Income Tax Act," updated May 7, 2002.

2. R.S.C. 1985, c. 1 (5th Supp.).

3. *A Second Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 23, 2004.*

4. *Budget Implementation Act, 2004, No. 2.*, R.S.C., 2005, c. 19.

5. The November 2006 proposal is a package of changes that consolidates and further amends previously proposed amendments introduced by the Department of Finance on December 20, 2002, December 5, 2003, February 27, 2004, and July 18, 2005, as well as amending provisions enacted by Bill C-33. The November 2006 Amendments are available on the Department's website.

6. For a discussion on the definitions for charitable organizations, public foundations, and private foundations, please see "Disbursement Quotas: What are they and how to comply," by M.E. Hoffstein and Adam Parachin, presented at the 2nd National Symposium on Charity Law on April 14, 2004.

7. Although the definition for disbursement quota in subsection 149.1(1) only makes reference to charitable foundations, this definition in effect also applies to charitable organizations – See paragraph 149.1(2)(b) and definition for "disbursement excess" in subsection 149.1(21) of the Act.

8. (a) Variables "A" and "A.1" were the same as above in relation to the disbursement quota for charitable organizations.

   (b) Variable "B" was 80% of all amounts received from other registered charities in its immediately preceding taxation year, other than specified gifts. For an explanation of the meaning of "specified gifts," see the section in this article in relation to the inter-charity transfer of specified gifts.

   (c) 4.5% of variable "D", having first deducted variables "E" and "F" from "D" (where variable "C" in the formula is the number of days in the taxation year).

   (d) Variable "D" was the average value (i.e., the "prescribed amount") of assets of the public foundation in the immediately preceding 24 months that was not used directly in charitable activities or administration of the foundation. Regulations 3700 to 3702 of the *Income Tax Regulations* provide a detailed mechanism to calculate the "prescribed amount" for purposes of calculating "D."

   (g) Variable "G" was a defined amount in the first ten taxation years of a public foundation commencing after 1983 and therefore was no longer relevant in 2005.

   (f) Variable "F" was 5/4 of "B," i.e., 100% of all amounts received from registered charities in its immediately preceding taxation year, other than specified gifts.

   (e) Variable "E" was 5/4 of the total of "A" and "A.1" for the year, i.e., 100% of the amounts included when calculating "A" and "A.1" referred to above, rather than 80%.

9. B.1 = C x 0.035 [D – (E + F)]/365) where:

   C = number of days in the taxation year, in order to prorate B.1 if there are less than 365 days in the charity's taxation year.

D = average value of the charity's assets in the 24 months immediately preceding the taxation year that were not used directly in charitable activities or administration of the charity.

E = A.1(a)(ii) + 5/4 of (A + A.1(a)(i))

F = 5/4 of B

10. This is because regulations are passed by Governor in Council, without the need to be passed by Parliament. The reduction of the 4.5% disbursement quota to 3.5% applies to taxation years of public and private foundations that begin after March 22, 2004. The application of the reduced 3.5% disbursement quota to charitable organizations is explained in the next section of this paper.

11. This amendment was achieved by changing the reference to "public foundation" or "charitable foundation" in the definition of disbursement quota in subsection 149.1(1) to "registered charity" and inserting references to "charitable organization" in other provisions of the Act where applicable. Paragraph 149.1(2)(b), dealing with the circumstances under which the charitable status for charitable organizations may be revoked, has also been amended to reflect that the 3.5% disbursement quota applies to charitable organizations. Alternate wording for paragraph 149.1(2)(b) has also been introduced to deal with the transition period for the application of the 3.5% disbursement quota to charitable organizations between 2004 and 2008. Similarly, paragraph 149.1(21)(c) regarding "disbursement excess" for charitable organizations has also been amended to reflect the changes to the calculation of disbursement quota ("disbursement excess" is the amount by which a registered charity's expenditure in the year exceeds its disbursement requirements for the year).

12. See subsections 149.1(2), (3) and (4) of the Act. For more information, please see *Charity Law Bulletin* No. 73, dated July 21, 2005.

13. Since foundations have always been required to satisfy the 4.5% disbursement quota (now 3.5%), it is not clear why the *de minimus* threshold would also need to apply to them.

14. Variable "A" includes 80% of the total of the eligible amounts of gifts for which the charity issued donation receipts in its immediately preceding taxation year, other than gifts that are:

    (a) enduring property; or

    (b) transfers from other registered charities.

    This new definition of the 80% disbursement quota is calculated upon the "eligible amounts" of gifts, which is a concept introduced by the Department as early as December 2002, which is now included in the proposed November 2006 Amendments. The November 2006 Amendments proposed to introduce new subsection 248(31) to provide that the "eligible amount" of a gift made after December 20, 2002 is the amount by which the fair market value of the property transferred to a charity exceeds the amount of the advantage in respect of the gift. This proposed amendment, together with other amendments proposed by the November 2006 Amendments, are intended to allow a donor to receive a donation tax receipt in situations whether the donor received a limited advantage as governed by the new split-receipting rules.

15. Details regarding amendments to subsections 118.1(5.2) and (5.3) of the Act concerning gifts of life insurance proceeds, registered retirement income fund and registered retire-

ment savings plan as a result of direct beneficiary designation are explained in the next section of this article.

16. CRA requires ten-year gifts be evidenced in writing. In light of the amendments contained in Bill C-33, it would appear necessary that in order to allow the capital gains to be available for encroachment, the document must also permit the original recipient charity and a subsequent transferee charity to expend the property before the end of the hold period to the extent permitted under the definition for disbursement quota in order to meet the disbursement quota requirement. According to CRA's *Registered Charities and the Income Tax Act*, RC 4108, the donor must sign the direction to make it valid. The direction must also accompany the gift; it cannot be added at a later date.

17. Paragraph (c) does not include gifts received from other registered charities, which are included in paragraph (d).

18. The English version of the amendments erroneously made reference to paragraph (b) instead of (c). However, the French version is correct. A proposed amendment is contained in the November 2006 Amendments to rectify this error.

19. Under the previous disbursement quota rules, CRA indicated in Technical Interpretation 9131785 dated December 19, 1991 that capital "should not be interpreted broadly to include all sources of funding received by way of bequest or inheritance." A charity was not able to simply assume that a charitable gift constitutes a bequest of capital simply because it was made pursuant to the terms of a will. For example, if a charity is designated in a will as the income beneficiary of a trust established under that will, the charity will have received an income rather than a bequest of capital. Under the new disbursement quota rules, this would not be problematic for the charity.

20. See also CRA's *Registered Charities Newsletter No.15*, dated April 2, 2003.

21. By amending subsections 118.1(5.2) and (5.3) of the Act and the definition of enduring property.

22. See CRA, *Information Circular* RC 4108 "Registered Charities and the Income Tax Act," May 7, 2002, and Summary Policy CSP – T06, dated September 3, 2003.

23. See the March 2004 Budget.

24. For example, consider a gift of $1,000 to a charitable foundation that is subject to a direction that it or property substituted therefor be held for a period of not less than ten years. Assume that due to the poor return on investment in the 12th year (i.e., after the ten year restriction has expired), no income is earned on the gift in a particular year. In order to meet the 4.5% disbursement quota, which would be equal to $45, the foundation would be required to encroach on the capital (because no income is generated in that year in the example). However, since the 4.5% disbursement quota and the 80% disbursement quota are cumulative disbursement obligations, the foundation would be required to disburse 80% of the amount of the capital encroached upon to satisfy the 80% disbursement quota, leaving only 20% of the amount encroached upon to satisfy the $45 disbursement obligation associated with the 4.5% disbursement quota. Consequently, although only $45 of capital is required to satisfy the 4.5% disbursement quota, the foundation would be required to encroach upon a total of $225 of capital (so that 80% of the $225, i.e., $180, would be used to satisfy the 80% disbursement quota and 20% of the $225, i.e., $45, would be used to satisfy the 4.5% disbursement quota).

25. The calculation for the amount for variable "D" remains substantially the same as the definition prior to the amendment, save and except the *de minimus* threshold of $25,000

mentioned above. The calculation of variable "D" is set out in Regulations 3700 to 3702 of the *Income Tax Regulations* to include the average value (i.e., the "prescribed amount") of assets of the charity in the 24 months immediately preceding that taxation year that was not used directly in charitable activities or administration of the charity if the amount of the investment assets calculated under variable "D" of the disbursement quota formula is greater than $25,000. Where the amount of investment assets is equal to or less than $25,000, variable "D" would be regarded as nil. It should be noted that the reference to variable "D" for purposes of calculating the limit on the encroachment does not take into account variables "E" or "F" as required when calculating the 3.5% disbursement quota under "B.1" which is described in the formula {C x 0.035 [D – (E + F)]}/365. "B.1" essentially provides that in applying the 3.5% disbursement quota percentage, one would exclude items that have been taken into account in other parts of the disbursement quota as they are expended. Thus "E" is intended to back out expenditures of certain enduring property and expenditures of receipted donation because they are otherwise brought into the disbursement quota test and "F" backs out receipts from other charities which are otherwise included in variable "B."

26. See subparagraph A.1(a)(i).

27. See subparagraph A.1(a)(ii).

28. This is achieved by applying variable "B" to charitable organizations. Variable "B" is now defined to mean as follows:

    (a) in the case of private foundations, variable "B" is the total of all amounts received by it in its immediately preceding taxation year from a registered charity, other than specified gifts or enduring properties; and

    (b) in the case of charitable organizations and public foundations, variable "B" is the same as the case for the private foundation, except that the inclusion rate is 80%, rather than 100%.

29. The term "ordinary gift" is not a term under the Act, but is used in this article to refer to transfers of property that are neither specified gifts nor enduring property.

30. This is so because variables "A.1" and "B" exempt specified gifts received from being included in the transferee charity's disbursement quota.

31. This is so because the expenditure of a specified gift is not exempt from variable "A.1(a)(ii)."

32. See explanation above concerning transfers of specified gifts.

33. Subsection 149.1(1) was amended by Bill C-33, consequential to the amendment of Part V of the Act in respect of taxes and penalties for which the charity is liable under subsection 188(1.1) or section 188.1 of the Act.

34. The following section is based on a paper "Disbursement Quotas: What They Are and How to Comply" by M.E. Hoffstein and Adam Parachin, presented at the Second National Symposium on Charity Law on April 14, 2004, which has been updated by the authors to reflect changes in the law.

35. Subsection 110.1(1)(a) and (b) and 118.1(1) of the Act.

36. By reason of these organizations being deemed to be registered charities under subsection 149.1(6.4) of the Act.

37. First introduced on February 27, 2004, this proposed amendment is included in the November 2006 Amendments. The Tax Court of Canada, in the case *Otineka Development Corporation Limited and 72902 Manitoba Limited v. The Queen*, held that an entity could be considered a municipality for the purpose of paragraph 149(1)(d.5) on the basis of the functions it exercised. However, the Quebec Court of Appeal in *Tawich Development Corporation v. Deputy Minister of Revenue of Quebec* ("Tawich") held that an entity could not attain the status of a municipality by exercising municipal functions, but only by statute, letters patent, or order. In response to the Quebec Court of Appeal decision in *Tawich*, the definition of qualified donee is proposed to be expanded to include municipal or public bodies performing a function of government in Canada.

38. Paragraph 149.1(6)(b), however, prohibits charitable organizations from disbursing more than 50% of their income in any year to qualified donees.

39. CRA, *Information Circular* 80-10R "Registered Charities: Operating a Registered Charity" at paragraph 35 (now repealed).

40. Paragraphs 149.1(6.1)(b) and (6.2)(b) of the Act. The political activities must be ancillary and incidental to a foundation's charitable purposes or a charitable organization's charitable activities; and must not include the direct or indirect support of, or opposition to, any political party or candidate for public office.

41. Paragraph 149.1(1.1)(b) of the Act.

42. See definition of "charitable organization in subsection 149.1(1) of the Act.

43. See definition of "charitable foundation" in subsection 149.1(a) of the Act.

44. See definition of "charitable purposes" in subsection 149.1(1) of the Act.

45. CRA, *Registered Charities Newsletter* No. 9, June 6, 2000.

46. These proposed changes were included in the draft amendments released on February 27, 2004, and the November 2006 Amendments without further change. Upon enactment of the proposed changes, it would apply retroactively to gifts made by charities after December 20, 2002. It is possible to transfer property to non-qualified donees, but not by way of "gift." Agency agreements and joint venture arrangements are alternative mechanisms through which to effect such a transfer.

47. Subsection 149.1(20) of the Act.

48. Paragraphs 149.1(2)(b), (3)(b) and (4)(b) of the Act.

49. Subsection 149.1(5) of the Act.

50. Form T2094 has recently been revised by CRA in September 2006.

51. CRA Summary Policy CSP-D03, dated October 25, 2002, and Information Letter CIL-1996-001, January 15, 1996, CIL-2001-002, January 16, 2001, and CIL-2002-002, February 19, 2002.

52. CRA Information Letter CIL-2001-002 January 16, 2001.

53. CRA has made it clear that the intention of subsection 149.1(8) is only restricted to accumulating property for a "particular purpose" which is interpreted by CRA to mean "the purpose or project for which the accumulated funds will eventually be spent as opposed to purchasing an annuity." CRA indicates that the accumulation must be for a "specified purpose that is particular and not general in nature, rather than an excuse to from meeting

its disbursement quota." Examples cited by CRA include accumulating funds to build a hospital wing, to purchase a costly piece of equipment, or to purchase land and buildings. CRA clarified that it is not intended to enable a charity to "capitalize funds and use only the interest income for charitable expenditures such as awarding annual scholarships to individuals." (See CRA Summary Policy CSP-A03, dated October 25,2 002, revised September 13, 2005, Policy Commentary CPC-005, May 25, 1992, Information Letter CIL-1995-005, dated March 13, 1995, and Information Letter CIL-1995-005, dated March 13, 1995)

54. See CRA Summary Policy CSP-D05 dated October 25, 2002 and Summary Policy CSP-D02 dated October 25, 2002. Form T2095 has recently been revised by CRA in September 2006.

55. For details, see *Charity Law Bulletin* No. 73, dated July 21, 2005.

56. These amendments, which were first proposed on December 20, 2002, revised on February 27, 2004, July 18, 2005, and finally in November 2006 are retroactive to January 1, 2000.

57. Paragraph 149.1(6)(b) of the Act.

58. Paragraph 149.1(6)(c) of the Act.

59. However, this requirement is not explicitly set out in the Act. Paragraph 149.1(6)(b) of the Act provides that charitable organizations may not disburse more than 50% of their income annually to qualified donees. The definition for "charitable foundation" in subsection 149.1(1) of the Act provides that a charitable foundation is "not a charitable organization." As such, CRA takes the administrative position that the language in the definition for "charitable foundation" would mean that public foundations must disburse at least 50% of their income to qualified donees.

60. As explained above, CRA takes the administrative position that the language in the definition for "charitable foundation" implies that public foundations must disburse at least 50% of their income to qualified donees. CRA also takes the administrative position that the definition for "private foundation" in subsection 149.1(1) of the Act indicating that a private foundation is a charitable foundation that is not a public foundation means that private foundations are not required to give at least 50% of their income annually to other qualified donees.

61. See the definition for "charitable organization" in paragraph 149.1(1) of the Act. See also CRA publication entitled "Registering a Charity for Income Tax Purposes" T4063.

62. See the definition for "charitable foundation" in paragraph 149.1(1) of the Act.

63. Paragraph 149.1(6)(a) of the Act.

64. See CRA, Policy Statement CPS – 019 entitled "What is a Related Business?" dated March 31, 2003.

65. Paragraph 149.1(4)(a) of the Act.

66. Paragraph 149.1(3)(d) and 149.1(4)(d) of the Act.

67. Paragraphs 149.1(3)(c) and 149.1(4)(c) of the Act.

68. Paragraph 149.1(12)(a) of the Act.

69. *Ibid.*

70. This means that, for purposes of the Act, charitable organizations are permitted to acquire control of a corporation. As such, CRA suggested that a charitable organization may operate a business through a taxable share capital corporation with the charitable organization retaining control over the taxable corporation "through share holdings or a power to nominate the board of directors." (See CRA Policy Statement CPS – 019 entitled "What is a Related Business?" dated March 31, 2003, at paragraphs 47 and 48) However, this option is not available to charities in Ontario as a result of the application of section 2(1) of the *Charitable Gifts Act* (Ontario) R.S.O. 1990, c. C.8, which provides that a charity is not permitted to own more than ten percent (10%) of an "interest in a business that is carried on for gain or profit is given to or vested in a person in any capacity for any religious, charitable, educational or public purpose." A charity, however, is permitted to invest in a business as a minority owner, provided that it does not "own," either directly or indirectly, an interest in excess of 10%. If the charity is found to own more than 10% of an interest of a business, it would have to dispose of any interest in excess of 10% within seven years, although it might be possible to obtain a court order to extend the seven-year period.