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A RISING TIDE?

EARLY EVIDENCE ON DISBURSEMENT QUOTA CHANGE

Research Bulletin

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A Rising Tide? : Early evidence on disbursement quota change

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Key findings

This Research Bulletin provides a preliminary examination of how foundations are responding to the new graduated disbursement quota (DQ) set out in Budget 2022. This quota requires charities with more than $1 million in property not used in charitable activities or administration (referred to hereafter as *non-charitable property*) to make qualifying disbursements equivalent to 5% of the value of this property, up from the previous 3.5%.

Looking at foundation T3010 filings for their first fiscal periods following the adoption of the new DQ we found:

- About 1,190 foundations, mainly private foundations, were affected by the changes. The rest either reported less than $1 million in non-charitable property or were already making qualifying disbursements exceeding the new requirements.
- Just over half of foundations (54%) did not meet their new disbursement requirement in the first year after the changes. Public foundations were somewhat less likely to fall short of requirements (49% vs. 55% for private foundations).
- Collectively, affected foundations look to have increased their qualifying disbursements by $711 million, with the vast majority of this increase (97%) due to increased disbursement rates (i.e., in response to the policy change). While private foundations drove most of this increase, they accounted for less than would be expected given the amount of non-charitable property they hold.
- While total disbursements increased by about $104 million more than the minimum needed to meet the new requirements, this was because some foundations over-contributed. Had they not done so, disbursements would have been $133 million short of the new requirements.
- Overall, new disbursements were divided about evenly between direct charitable activity (34%), gifts to qualified donees (36%), and grants to non-qualified donees (31%). Public foundations focused much more on increasing gifts to qualified donees (91% of increased disbursements) while private foundations divided their increases between gifts (38%) and grants (36%).
- The first year of the new requirements appears to have been particularly challenging due to macroeconomic factors. The new higher demands followed a period with relatively poor investment performance, which likely explains some part of why so many foundations did not meet the new requirement.

Introduction

As part of Budget 2022, the Federal government announced the adoption of a graduated disbursement quota (DQ) for charities with more than $1 million in investment assets[1] (Department of Finance Canada, 2022). It requires charities to make qualifying disbursements equivalent to 3.5% of the first $1 million of these assets and 5% of the amount in excess of $1 million. The new measure took effect for fiscal periods beginning on or after January 1, 2023 and is to be reviewed after five years. In addition, charities were allowed to make grants to non-qualified donees and Canada Revenue Agency was directed to improve its collection of information related to the disbursement quota, investments, and donor-advised funds (DAFs).

The new quota came after a number of advocacy campaigns aimed at increasing the DQ to make more funds available to charities struggling to cope with the COVID-19 pandemic (e.g., Give5, 2020; Hallward, 2021; Hassan, 2021). This idea was not new (e.g., Blumberg, 2012), but the concept had gained little traction without the catalyst of the pandemic. Characteristically, the pandemic-era advocacy campaigns juxtaposed the considerable assets foundations had amassed over previous years against heightened demand for services from a charitable sector under unprecedented financial pressures. In response, Budget 2021 announced that the Federal government would be launching public consultations with charities, looking at potential increases to the disbursement quota (Department of Finance Canada, 2021). These consultations were held between August 6 and December 2, 2021 and received approximately 120 submissions from charities. Submissions were roughly evenly divided between those advocating for an increased DQ and for keeping it the same (The Muttart Foundation, 2022). These consultations, along with advocacy in response to the proposed legislation, helped inform the new DQ regime.

Currently, the new quota has been in effect for just over two years and T3010 filings are sufficiently complete to support reliable preliminary analysis.[2] In this Research Bulletin we provide an assessment of the early impact of the DQ changes to help ensure that stakeholders are informed prior to the forthcoming review. Our primary focus is on assessing the extent to which the value of foundation disbursements has increased as a result of the new quota, as well as the possible impact on foundation assets. Secondarily, we look at at how the nature of qualifying disbursements have changed.

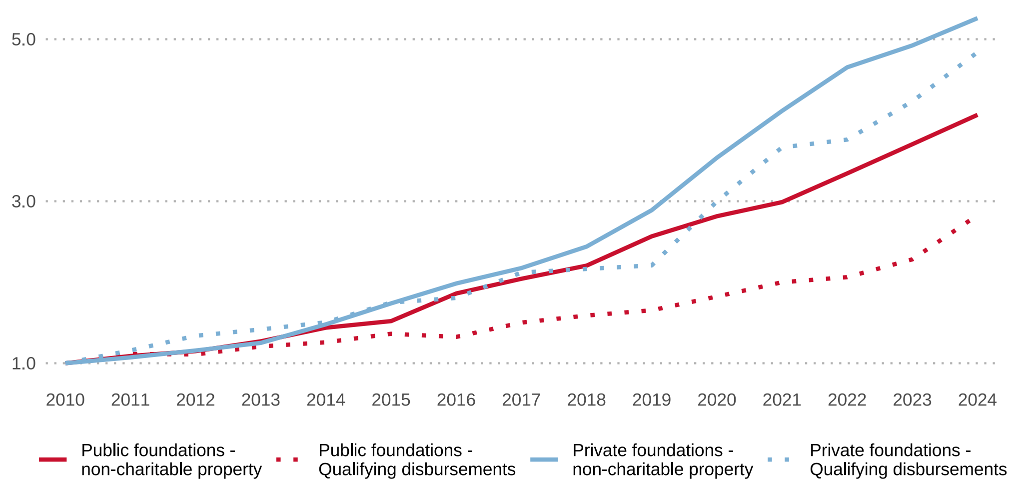
[1] While Budgets 2022 and 2021 use the term "investment assets" and contain analyses based on the value of long-term investments, the disbursement quota is based on the value of charitable property not directly used in charitable activities or administration, as recorded on line 5900 of the T3010 Information Return.

[2] At the time of writing roughly 83,800 charities have filed one post-change return and 47,800 have filed a second.

Background

As noted in Budget 2021, the value of investment assets held by public and private foundations has grown significantly faster than their charitable spending. Since 2010, the value of private foundation property not used in charitable programming or administration (referred to hereafter as "non-charitable property") has increased by a factor of 4.3, compared with 3.8 for qualifying disbursements (see Figure 1). The divergence is larger for public foundations, where non-charitable property has increased 3.1 times versus 1.8 times for disbursements. Overall, disbursement growth has tracked growth in non-charitable property more closely among private foundations than among public foundations, where the gap has generally widened.

Figure 1: Relative growth in non-charitable property and qualifying disbursements, public and private foundations, 2010 - 2024, 2010 = 1.00[3]



When interpreting these figures, it is important to recognize that they are aggregate measures. Much of the observed trend is driven by a small number of very large foundations, particularly for private foundations. Most foundations have not experienced these levels of growth, and the size of the gap between non-charitable property and disbursements in any given year is not necessarily very informative

[3]Budget 2021 contrasted the relative growth of foundation assets and disbursements using long-term investments (line 4140 of the T3010 Return), rather than the value of property not directly used in charitable activities or administration (line 5900), as shown here. They appear to have used long-term assets as a proxy measure because line 5900 reporting has historically been somewhat incomplete. However, with the increased attention to the DQ since Budget 2021, line 5900 reporting has significantly improved and we show it here because it is the basis for DQ calculations and compliance assessment. In the interest of comparability, Figure B-1 in Appendix B provides an update to the Budget 2021 analysis, showing how long-term investment growth has continued since 2019.

about the extent to which individual foundations are exceeding or failing to meet their disbursement quotas. In addition, because DQ calculations are based on the average value of non-charitable property over the two years *prior* to the beginning of the fiscal period, the gap between disbursements and non-charitable property naturally tends to be smaller than the gap between disbursements and other asset measures, such as long-term investments, when assets are appreciating, as they have tended to do over the period observed.

i How is the DQ calculated?

The disbursement quota (DQ) for a given fiscal period is calculated based on the average value of non-charitable property (i.e., property not directly used for charitable activities or administration) during the 24 months prior to the beginning of the period, as reported on line 5900 of the T3010 return. The DQ applies to public and private foundations with more than $25,000 and operating charities with more than $100,000 of non-charitable property.[4]

Prior to the new rules, the DQ was equivalent to 3.5% of the value of this property. For periods starting on or after January 1, 2023 the quota is equivalent to 3.5% of the first $1 million and 5% of the value above $1 million.

As a result of the new rules, every foundation with more than $1 million in non-charitable property has a different required effective disbursement rate. As an example, a foundation with $1.5 million in non-charitable property would have to meet an effective disbursement rate of 4.0%. The required disbursement would be $55,000, calculated as 3.5% of the first million and 5% of the remaining $500 thousand, or $35,000 + $25,000. This is equivalent to 4.0% of the $1.5 million in non-charitable property. A foundation with $3 million in non-charitable property would have a required effective rate of 4.5% and a foundation with $6 million a rate of 4.75%.

Charities meet their DQ by making *qualifying disbursements*, defined as spending on charitable activities, gifts to qualified donees and grants to non-qualified donees. Fundraising, management and administration costs do not count as qualifying disbursements. Disbursement shortfalls in a given fiscal period can be covered by drawing on excess disbursements from any of the five previous periods or by creating an excess in the next period.

[4] For more detail on what constitutes non-charitable property, please see the Methodology section in Appendix A.

Assessing the impact of DQ changes

The first step in evaluating the impact of the DQ changes is to identify the population of foundations affected by the new policy. Prior to the passage of Bill C-19, the bill implementing the new DQ, the Department of Finance assessed that the changes would cover about 4,000 charities, of which approximately 1,400 would be required to increase their annual disbursements (House of Commons Standing Committee on Finance, 2022). The 4,000 figure appears to reference the number of charities then reporting non-charitable property of $1 million or more in the most recent complete year then available for analysis, while the 1,400 figure represents the number of those disbursing less than the required equivalent value of their non-charitable property.

Looking at the fiscal periods immediately prior to the DQ changes and narrowing our focus to foundations, we identified 2,920 foundations reporting over $1 million in non-charitable property. Adjusting the compliance calculation to account for the ability to carry forward excess disbursements, we then determined that approximately 1,190 of these foundations were disbursing below the levels required by the new quota. We considered these foundations to be in-scope for the changes.[5]

Overall, we judged that 41% of foundations with more than $1 million of non-charitable property were in-scope, equivalent to 10.6% of all foundations. Collectively, in-scope foundations hold slightly more than three-fifths of total non-charitable property and long-term investments held by foundations (see Table 1). They account for a somewhat smaller share of total assets and a markedly smaller share of qualifying disbursements, the latter reflecting their generally lower disbursement levels compared to other foundations. Approximately 80% of in-scope foundations are private foundations and they account for disproportionately large shares of assets and qualifying disbursements compared with in-scope public foundations.

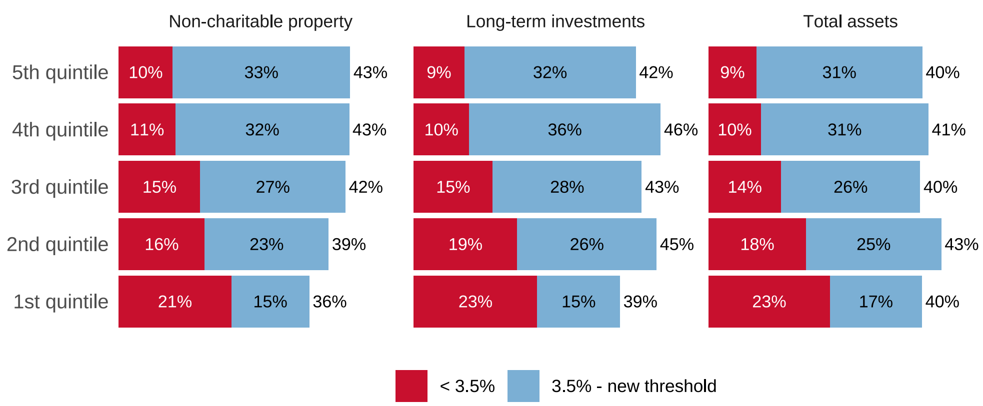
Table 1: Shares of non-charitable property, long-term investments, assets, and qualifying disbursements by applicability of DQ change and designation, fiscal periods immediately prior to DQ change

Status for DQ changes / designation	Non-charitable property		Long-term investments		Total assets		Qualifying disbursements	
	value	% total	value	% total	value	% total	value	% total
In-scope	$70.5B	61%	$64.7B	61%	$76.6B	53%	$3.0B	22%
Public foundations	*$7.0B*	*6%*	*$5.2B*	*5%*	*$6.5B*	*5%*	*$279.2M*	*2%*
Private foundations	*$63.5B*	*55%*	*$59.5B*	*56%*	*$70.1B*	*48%*	*$2.7B*	*20%*
Out of scope	$45.6B	39%	$42.0B	39%	$68.2B	47%	$10.2B	78%

[5] For a complete description of the analytical process, please see Appendix A.

Because a smaller proportion of their non-charitable property is subject to the new 5% threshold, foundations with less non-charitable property are somewhat less likely to be in-scope for the DQ change (see Figure 2). Focussing on foundations with more than $1 million in non-charitable property, just over a third of foundations in the lowest non-charitable property quintile were in-scope, compared to just over two fifths of foundations in the top three quintiles. However, while these foundations are less likely to be in-scope for the DQ change, they may face greater difficulty meeting the new requirements, as indicated by the larger percentages disbursing below the pre-DQ change 3.5% threshold. The situation is very similar when looking at the distributions of both long-term investments and total assets.

Figure 2: Percentage of foundations in-scope for DQ changes and disbursing in key ranges by quintile of non-charitable property, long-term investments, and total assets, foundations with more than $1 million of non-charitable property, fiscal period immediately prior to DQ change

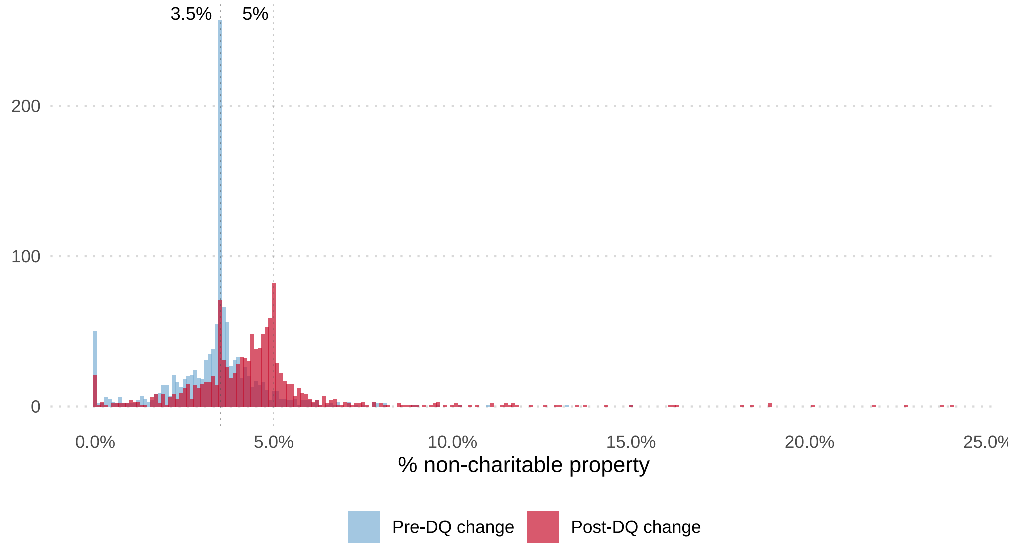


Impact on qualifying disbursements

Looking at the annual qualifying disbursement rates[6] of in-scope foundations immediately before and after the DQ change, there are clear indications of a significant shift (Figure 3). Immediately prior to the DQ change, disbursements cluster around the 3.5% level. Afterwards, they show a somewhat looser cluster around the 5% level, with a tail skewing towards lower disbursement levels and a spike at the previous 3.5% quota.

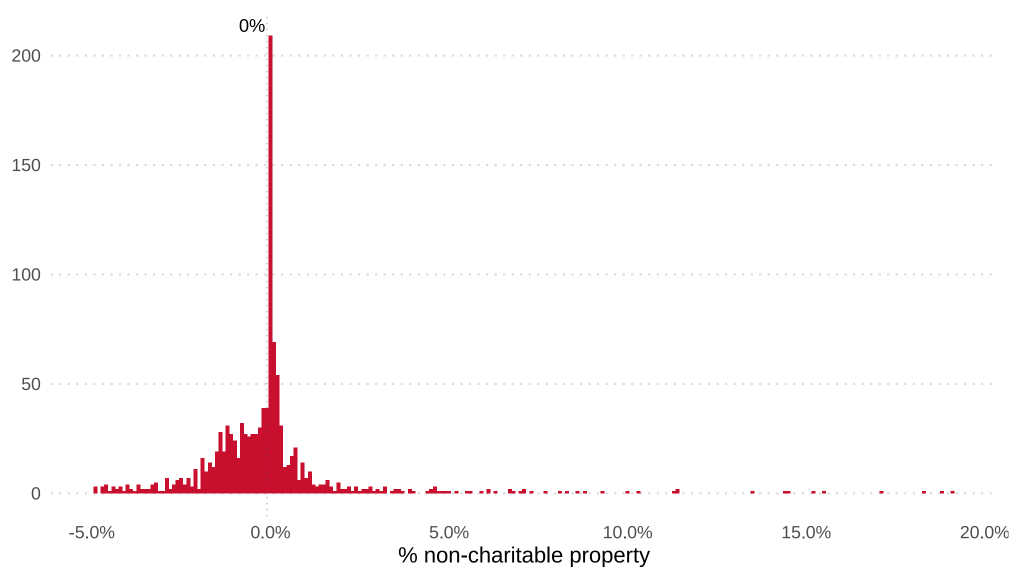
[6] The qualifying disbursement rate is the value of qualifying disbursements as a percentage of non-charitable property. Annual disbursement rates are calculated for a single year, rather than over multiple years accounting for carry forward of excess contributions. We used annual rates here to make the contrasting behaviours more apparent.

Figure 3: Distribution of annual qualifying disbursement rates, in-scope foundations, pre- and post-DQ changes



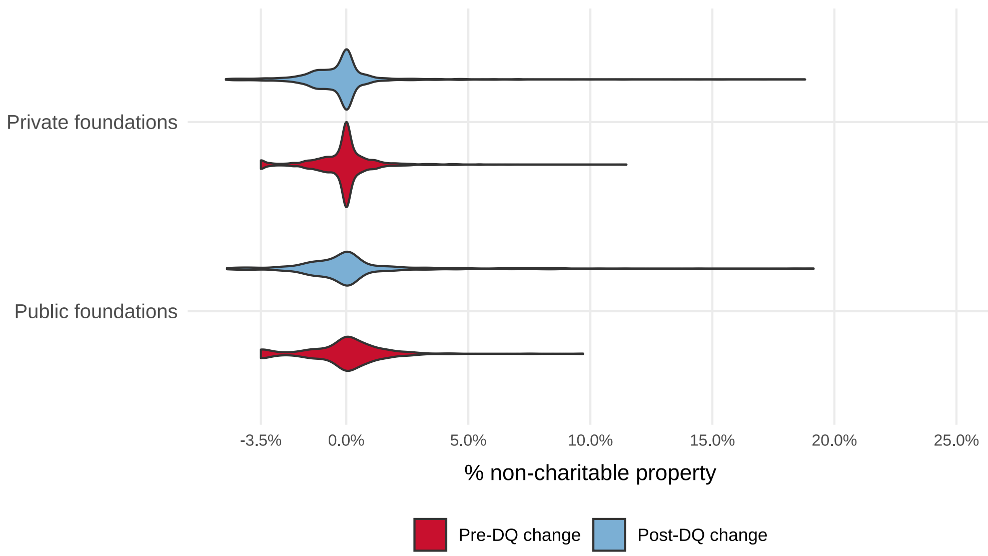
While we naturally expect many foundations to disburse less than 5% of the value of their non-charitable property because their required effective disbursement rates are lower, the *degree* to which foundations disbursed less than 5% significantly exceeds what we would expect from the quota structure alone (see Figure 4). Overall, a majority of in-scope foundations (54%) disbursed below their new requirement in their first fiscal period after the change. Many foundations appear to be taking time to increase their disbursements to their new effective rate, apparently intending to use excess disbursements in future years to cover current shortfalls.

Figure 4: Divergence from annual required effective disbursement rates, in-scope foundations, post-DQ change



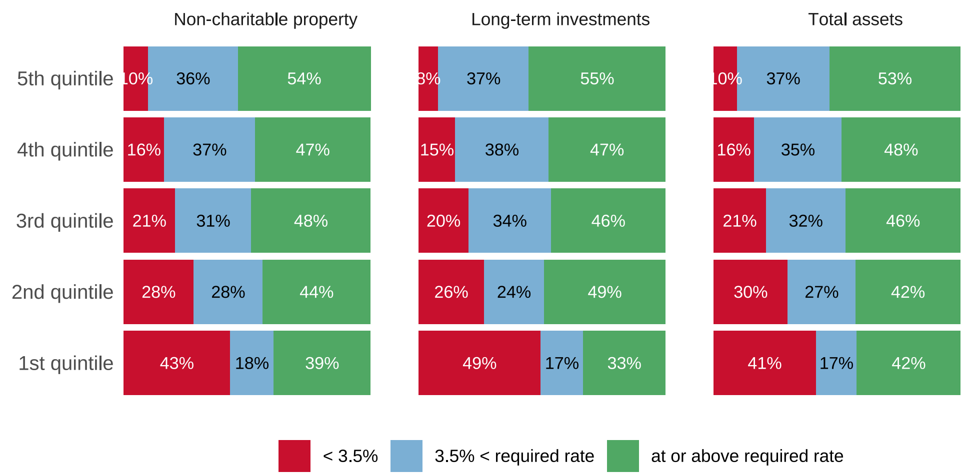
Just over half of private foundations (55%) and just under half of public foundations (49%) disbursed below their annual required effective disbursement rates in the first period after the DQ change. Comparing pre- and post-DQ divergences from required disbursement levels, private foundations were more likely to have been disbursing at or near their pre-DQ quota than public foundations, which showed more variability (see Figure 5). After the change, the degree to which both groups look to be below their annual effective disbursement rate looks to be broadly similar, though private foundations continue to cluster more tightly around their required threshold than public foundations.

Figure 5: Divergence from annual required effective disbursement rates as a percentage of non-charitable property by designation, in-scope foundations, pre- and post-DQ change



In-scope foundations with less non-charitable property were less likely to have disbursed at or above their required effective disbursement rate than foundations with more property. About two in five foundations in the lowest quintile of non-charitable property disbursed at or above their required rate compared to just over half of foundations in the highest quintile (see Figure 6). Lower quintile foundations were also markedly more likely to be disbursing below the previous 3.5% threshold. Again, as with pre-DQ change disbursements, patterns were very similar when looking at the distributions of long-term investments and total assets.

Figure 6: Annual qualifying disbursement rates by quintile of non-charitable property, long-term investments, and total assets, in-scope foundations, post-DQ change



Monetary impact. Collectively, in-scope foundations increased their post-DQ change qualifying disbursements by approximately $711 million beyond the amounts they disbursed during their last pre-DQ change fiscal periods. The vast majority of this increase (97%) was driven by increased disbursement rates, with the remainder driven by increases in the underlying value of non-charitable property. Although a large majority of the disbursement increase (85%) was driven by private foundations (see Table 2) this is actually somewhat lower than might be expected, given that they account for fully 90% of non-charitable property held by in-scope foundations.

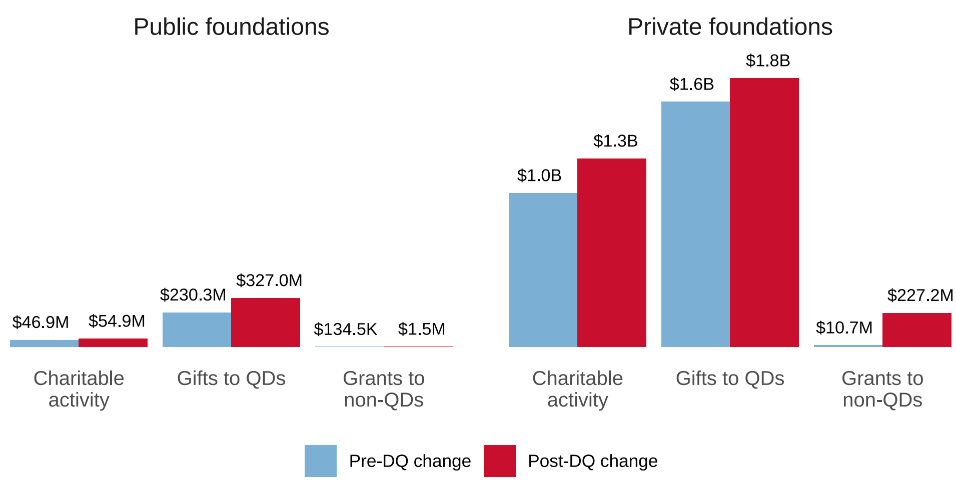
Table 2: Monetary impact of disbursement changes, in-scope foundations, fiscal periods immediately after DQ change

Measure	Private foundations		Public foundations	
Disbursement increase	$605.4M		$106.1M	
Difference from target	$74.7M		$29.5M	
Driven by disbursement rate increase	96.3%		98.6%	
Foundation performance	**%**	**Amount**	**%**	**Amount**
At or over annual target / over-contribution	45.4%	$197.7M	50.7%	$39.7M
Below annual target / under-contribution	54.6%	-$122.9M	49.3%	-$10.2M

As a group, in-scope foundations contributed about $104 million more than required to meet their new minimum disbursement requirements. However, this was because 46% of foundations exceeded their minimum annual requirement and these over-contributions compensated for the shortfalls of the majority of foundations that did not meet their new annual disbursement requirement. Without these over-contributions, disbursements would have been $133 million short of the amount required to meet the annual requirement. This is particularly significant because over a third of the surplus can be attributed to a single very large private foundation.

Changes to disbursement patterns. Collectively, in-scope foundations divided their increased qualifying disbursements fairly evenly between direct charitable activities (34%), gifts to qualified donees (36%) and grants to non-qualified donees (31%), with each category accounting for roughly a third of the $711 million increase. However, public and private foundations allocated their increased disbursements quite differently. Among public foundations, the vast majority of the increase (91%) came in the form of gifts to qualified donees, which increased by about 41% compared to the fiscal period prior to the DQ change (see Figure 7). For private foundations, increased disbursements were more evenly distributed, with the largest proportions going to charitable activities (38%) and grants to non-qualified donees (36%). Looking at gifts to qualified donees, even though the absolute dollar value of the year over year increase in gifts was larger for private foundations than public foundations, the incremental increase was much smaller as a percentage of value (10% vs. 41% for public foundations).

Figure 7: Amount of qualifying disbursements by type, pre- and post-DQ change, in-scope foundations, by designation

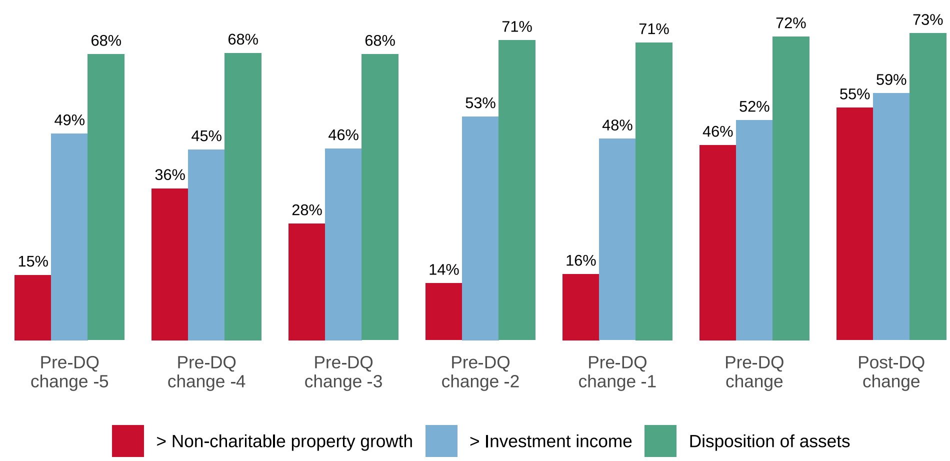


Impact on assets

It is important to understand from the outset that our ability to assess the impact of the DQ changes on foundation assets is limited. Firstly, because complete data are available for just one post-change fiscal period, we can only identify very short-term impacts. Secondly, the T3010 lacks key data needed to fully assess the impact on foundation assets, chiefly investment returns and revenues from the disposition of assets specifically related to non-charitable property. While the T3010 *does* record investment income and income from the disposition of assets generally, it is impossible to determine what fraction is specifically linked to non-charitable property.

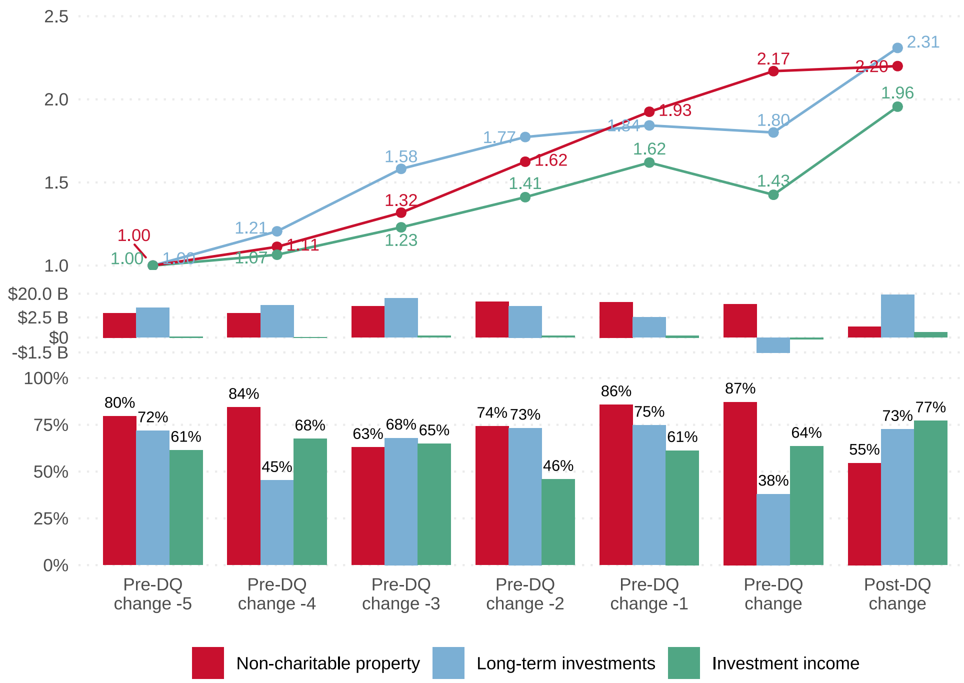
The above limitations noted, there are a number of potentially useful indicators that can be compared to previous norms. After the DQ change, about three fifths (59%) of in-scope foundations increased their disbursements by more than their investment income increased compared to the fiscal period prior (i.e., increased disbursements outstripped increased investment income; see Figure 8). This was somewhat higher than that the percentages seen during most previous years. Divergence from historical norms was much greater when comparing disbursements to increases in the value non-charitable property. Just over half (55%) of in-scope foundations increased their disbursements by more than the value of their non-charitable property increased during the period, substantially above historical norms.

Figure 8: Percentages of organizations disbursing more than non-charitable property or investment income increases or reporting income from disposition of assets, in scope foundations



While the above measures do seem to be departures from historical trends, there is reason to believe that they are more driven by macroeconomic factors than unsustainable disbursements. The major shift with regards to non-charitable property pre-dates the DQ changes and there is little indication that more organizations are liquidating assets to cover shortfalls, as we would expect if there were significant encroachments on capital. Juxtaposed against this, the value of long-term investments and investment income largely stagnated during the two years prior to the DQ changes, likely driven by relatively weak Canadian investment returns over the period, while the average value of non-charitable property, lagged by two years, continued to increase (see Figure 9). The net effect for many foundations was that the new higher disbursement requirements coincided with somewhat lower capacity to meet them. This goes some way to explaining the high percentage of them not meeting the new requirement in the first fiscal period after the change.[7]

Figure 9: Indices and absolute growth in non-charitable property, long-term investments, and investment income and percentages of foundations showing year to year growth in these values, in-scope foundations



Summary and discussion

Overall, our assessment of the early impacts of the DQ changes shows that while foundations have significantly changed their disbursement patterns many are not, as of yet, fully meeting the new requirements. That said, the net financial effect is relatively small due to the fact that larger foundations are more likely to be disbursing near their new required thresholds. The fact that many foundations are not disbursing at the new level should not be surprising, given that a significant minority of foundations disbursed less than the previous lower requirement over extended periods.

[7] We say *some* way to explaining this because a significant fraction of the under-spending does seem to be a matter of choice. Roughly half of foundations that did not meet their new annual disbursement requirement reported enough net revenue for the period that they could, at least in theory, have covered the shortfall.

Beyond the preliminary assessment of how foundations are responding to the new DQ requirements, the most significant outcomes of this exercise are probably better understanding of the scale of the potential impact of the policy changes and the difficulty of fully evaluating their outcomes.

Because we focus narrowly on non-charitable property and foundations known to be in-scope for the changes, our estimate of the financial impact is somewhat lower than other figures we have seen reported. While it is certainly likely that there are some foundations in-scope that we have not identified because they did not report having charitable property, the impact of this on total disbursements is likely quite modest.[8]

Our current understanding of the impact of the DQ changes on foundations is significantly limited by the data available. To fully understand the impact of these changes requires more detailed information on investment returns and transactions related to non-charitable property. Future forecasting would require information about investment portfolio composition that we currently lack. Significantly, the data deficit extends beyond these narrowly defined issues. We have said comparatively little in this Bulletin about how disbursement patterns might have changed due to the new requirements, omitting any discussion of how the causes and organizations supported might have shifted. This is entirely due to limitations in reporting (i.e., a high rate of incomplete or erroneous filings). Identifying where foundations allocate their gifts should be a fairly trivial exercise, but because such a high fraction of reported gifts do not include or correctly report the required charitable number for the qualified donee, these data must be very laboriously reconstructed. The situation is similar with the reporting of grants to non-qualified donees.

Looking forward, it is clear that the forthcoming five year review of the new policy will be quite challenging. Because of its very nature, the policy has to be in effect for an extended period in order for its effects to be felt. Our understanding of these effects, even over an extended period, will be incomplete due to data limitations. Added to that, we are seeing significant macroeconomic effects due to a combination of pandemic aftermath and significant dislocations in the global economy. All this highlights the need for diligent efforts to accurately assess the impact of these policy changes and engage a broad range of stakeholders in understanding how the changes are affecting them.

[8] As a rough back of envelope check, foundations with total assets over $1 million that have *not* reported having non-charitable property accounted for about 8% of total assets over $1 million immediately before the DQ change. Just under half of these foundations disbursed less than the equivalent of 5% of the value of their total assets during that period.

Appendix A - Methodology

We computed the disbursement quota (DQ) based on the average value of non-charitable property during the 24 months prior to the beginning of the fiscal period, as reported on line 5900 of the T3010 return. *Non-charitable property* includes real estate, investments, and other assets not used directly in charitable activities or administration. Examples specified in Canada Revenue Agency guidance include investments such as stocks, bonds, mutual funds or GICs, land or buildings, and cash in bank accounts.

Charities meet their DQ by making *qualifying disbursements*, computed as the sum of spending on charitable activities (line 5000), gifts to qualified donees (line 5050) and grants to non-qualified donees (line5045). Fundraising, management, and administration costs do not count as qualifying disbursements. Significantly, disbursement shortfalls in a given fiscal period may be offset using excess disbursements from the five previous periods and/or by creating an excess in the immediately following period (i.e., drawing any available excess from the five years before and one year after a given fiscal period).

For charities that were given permission to accumulate property prior to December 31, 2022 we reduced the value of non-charitable property by the net value of that property. In addition, charities can apply for approval to reduce their DQ for a given period, which is then used to amend their T3010 return. Thus far, only a literal handful of foundations appear to have applied for this approval and these adjustments have had no impact on our analysis.

Identification of in-scope foundations. To assess which foundations were in-scope for our analysis, we compared their actual disbursements prior to the DQ change with hypothetical quotas based on the new requirements (i.e., we compared what they disbursed with the minimum they would have been required to disburse *if* the new quota had been in force). Foundations disbursing below their minimum hypothetical requirement in the fiscal period immediately prior to the changes were considered in-scope for our analysis, while foundations already disbursing at or above their hypothetical quota were considered out of scope.

Actual disbursements were computed using the value of qualifying expenditures and non-charitable property held over up to six fiscal periods before the DQ changes. We did this because foundations can carry-forward excess qualifying disbursements for up to five years to cover disbursement shortfalls.[9] Where foun-

[9] Because it would bias our understanding of how foundations are responding to the new requirements, we did not carry-back over-contributions from the period immediately *after* the DQ changes.

dations entered permitted accumulated property values, we adjusted the figures accordingly.

Required disbursements were computed individually for each foundation, based on the amount of non-charitable property they reported for the period immediately prior to the DQ changes. We computed individual rates because effective disbursement rates vary significantly with the proportion of non-charitable property above the $1 million threshold.[10] Had we used an arbitrary 5% threshold, we would have systematically over-stated the number of smaller foundations that were in-scope for the DQ changes.

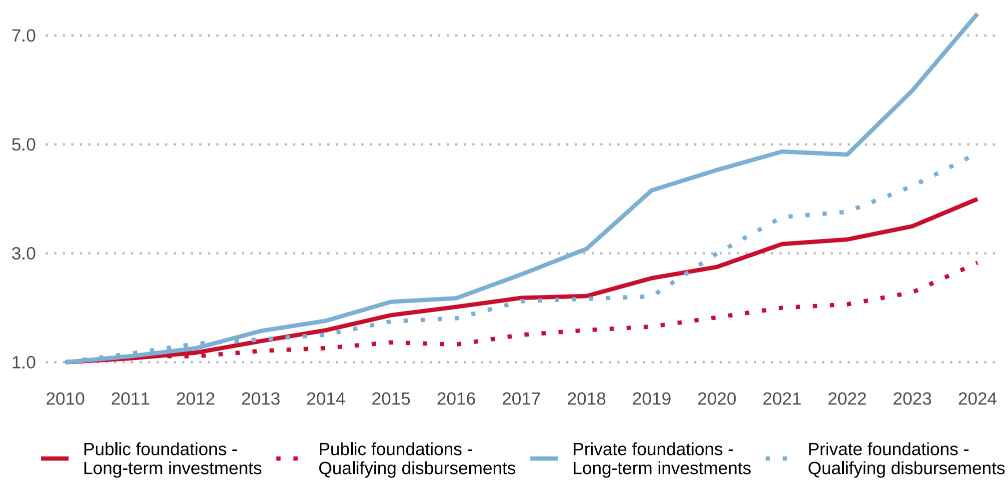
Evaluation of changes to disbursement levels. Response to the DQ changes was evaluated using annual disbursement calculations for the fiscal periods immediately before and after the DQ change (i.e., without accounting for carry-forward and -back of excess disbursements or shortfall). We did this because we are attempting to identify behavioural changes over a single fiscal period and because filings for the second period after the DQ changes are not yet complete. Additionally, given common disbursement patterns, where foundations cover multiple year shortfalls with large over-contributions in a single year, attempting to account for carry-forward and -back would have systematically under-estimated foundation response to the DQ changes.

Treatment of missing values. Analysis of DQ changes was restricted to foundations reporting non-charitable property on line 5900 of their T3010 returns. We did not attempt to impute a value for non-charitable property when one was not reported. Historically, reporting of non-charitable property has been quite incomplete but it has materially improved over the last few years, particularly since the changes to the DQ and the addition of Schedule 8 to help guide DQ calculations. In the period immediately prior to the changes, foundations reporting non-charitable property accounted for 92% of total foundation assets, 95% of long-term investments, and 78% of qualifying disbursements. While some portion of non-charitable assets is doubtless still going unreported, the impact on our analyses is likely to be quite modest.

[10] As an example, a foundation with $1.5 million in non-charitable property would have a required effective disbursement rate of 4.0%, while a foundation with $3 million would have a required effective rate of 4.5%, and a foundation with $6 million 4.75%.

Appendix B - Supplemental figures

Figure B-1: Relative growth in long-term investment assets and qualifying disbursements, public and private foundations, 2010 - 2024, 2010 = 1.00



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