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## BE CAREFUL WHAT YOU ASK FOR: CRA PROPOSED POLICY ON FUNDRAISING

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### A. INTRODUCTION

Following the release of the proposed policy on fundraising on March 31, 2008 (the “Proposed Policy”), Canada Revenue Agency (“CRA”) released a 30-page background information document (the “Backgrounder”) on June 26, 2008 providing a detailed explanation of various terms and concepts contained in the Proposed Policy.<sup>1</sup> The Proposed Policy was developed by CRA in response to a growing demand from the media and the general public for more accountability from charities concerning the quantum of fundraising expenses and the appropriateness of certain fundraising activities. The Proposed Policy has received mixed response from the charitable sector and considerable media coverage that led even to a front page article in the *Toronto Star* shortly after it was released.<sup>2</sup> The Proposed Policy was reviewed in *Charity Law Bulletin* No. 138.<sup>3</sup> Section B of this *Bulletin* briefly summarizes what is contained in the Proposed Policy and provides an overview of the detailed Backgrounder. However, the Proposed Policy and Backgrounder also raise many concerns for the charitable sector in terms of how these two documents may affect their fundraising activities and how the Proposed Policy may be administered by CRA. Comments on the implications in this regard are set out in section C of this *Bulletin*.

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<sup>1</sup> The Proposed Policy and the Backgrounder are available on CRA’s website at <http://www.cra-arc.gc.ca/tax/charities/consultations/fundraising-e.html> and : <http://www.cra-arc.gc.ca/tx/chrts/cnslttns/fndrsng-eng.html> respectively.

<sup>2</sup> Kevin Donovan, “Watchdog Sets Charity Rules” *Toronto Star*, May 5, 2008.

<sup>3</sup> Available on our website at [www.charitylaw.ca](http://www.charitylaw.ca).

Due to the detailed nature of the Backgrounder, it is not possible to provide an in-depth analysis of the Backgrounder in this *Bulletin*. As such, readers are encouraged to review both the Proposed Policy and the Backgrounder in detail in order to have a full understanding of what is being proposed by CRA. Charities are also strongly encouraged to review these documents to determine, in the event that the Proposed Policy is adopted by CRA as currently drafted, how it may impact their operations and what changes will need to be put in place to comply with those requirements.

Consultation concerning the Proposed Policy was originally scheduled to close on June 30, 2008. As a result of concern from the charitable sector concerning its inability to provide meaningful comments on the Proposed Policy without being provided with a detailed explanation of what is being proposed, the consultation period has now been extended to August 31, 2008, following the release of the Backgrounder at the end of June.

## **B. OVERVIEW OF PROPOSED POLICY AND BACKGROUNDER**

This section of the *Bulletin* briefly summarizes what is contained in the Proposed Policy and an overview of the Backgrounder.

### 1. The difference between fundraising and charitable purposes or activities

The Proposed Policy reviews the difference between fundraising and charitable purposes or activities that may be conducted by charities. The Proposed Policy indicates that all registered charities are required by law to have exclusively charitable purposes. As the *Income Tax Act* (the “Act”) does not define what is charitable, the common law provides guidance in determining the definition of charity in its legal sense and in applying that definition. The courts have determined that fundraising is not in-and-of-itself charitable. As a result, fundraising activities are not normally treated as advancing a charity’s charitable purpose and fundraising costs cannot usually be reported on a charity’s annual T3010A information return as charitable expenditures. The Proposed Policy indicates that not every action of a registered charity is required to be in-and-of-itself charitable. Therefore, charities can undertake fundraising activities to support their charitable purposes, even though fundraising activities, taken alone, would not necessarily be charitable. The Proposed Policy also clarifies that certain fundraising activities are specifically permitted under the Act (such as fundraising through related business where it is substantially run by volunteers, or fundraising to disburse funds to qualified donees that are not registered charities). The Backgrounder does not provide any further guidance on this issue.

## 2. Prohibited conduct

The Proposed Policy indicates the following four areas of prohibited conduct related to fundraising activities that are the principal grounds for revocation of a registered charity's status, imposition of sanctions or other compliance actions, or for denial of charitable registration:

- a) conduct that is illegal or contrary to public policy;
- b) conduct that results in excessive or disproportionate private gain by individuals or corporations;
- c) conduct that has become a main, prevailing, or independent purpose of the charity; and
- d) a charity not devoting 100% of resources to charitable ends since the harm arising from the charity's fundraising practice outweighs its public benefit.

A detailed explanation on each of the areas of prohibited conduct is provided in the Backgrounder, including the following:

a) Conduct that is illegal or contrary to public policy – The Backgrounder indicates that fundraising activity can be illegal because it is contrary to the Act or other statutory provisions,<sup>4</sup> or activities that “facilitate or advance an illicit gifting arrangement” or involve improper issuance of donation receipts. Fundraising activities can be contrary to public policy if they result in incontestable harm to the public interest (e.g. fundraising contracts that misrepresent to the public about whether donated amounts go to the charity or to pay the fundraising company) or if they do not comply with government policy.

b) Conduct that has become a main, prevailing, or independent purpose of the charity – The Backgrounder indicates that fundraising activities cannot become a collateral purpose of a charity, where it is an end-in-itself, instead of a means to achieve an end. Charities are permitted to have a fundraising purpose, but that fundraising purpose must be ancillary (i.e. subordinate or secondary to other purposes) and incidental (i.e. to arise out of, or depend on, the other purposes and be relatively modest in size) to their broader charitable purposes.

c) Conduct that results in excessive or disproportionate private gain by individuals or corporations – Although charities cannot be established to confer private benefits, some private benefit may arise when

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<sup>4</sup> Such as where it is criminally fraudulent or violates federal or provincial statutes governing charitable fundraising, charitable gaming, the use of charitable property, or consumer protection.

pursuing charitable objects. However, any benefit conferred to a third party is only acceptable as a minor and proportionate by-product of the activity undertaken to fulfill a charitable purpose. For example, charities cannot enter into fundraising agreements that result in private benefit that is not incidental (because the amount or percentage of gain to non-charitable parties is excessive).

d) A charity not devoting 100% of resources to charitable ends since the harm arising from the charity's fundraising practice outweighs its public benefit – The Backgrounder indicates that charities cannot undertake fundraising activities that are deceptive or misleading to donors (such as the geographic area in which they work, the amount or what types of work they do, or the percentage of the donations that will go to charitable work, etc.) or impairs the fundraising efforts of other charities.

### 3. Fundraising activities and solicitation of support

The Proposed Policy indicates that in general charities are to report on their T3010A return as fundraising expenditures all costs related to any activity that includes a solicitation of support or is undertaken as part of the planning and preparation for future solicitations of support, unless it can be demonstrated that the activity would have been undertaken without solicitation of support.

The Backgrounder clarifies that an “activity” can be a single action (e.g. an advertisement published in a newspaper) or a series of related actions (e.g. a capital campaign). It further clarifies that a fundraising activity may be an external activity (e.g. telemarketing, direct mail, putting on events, distributing information through the media or a charity's own publications) or an internal activity (e.g. prospect research or hiring fundraisers). It also clarifies that whether such activities are carried out by a third party under contract, by staff, or by volunteers of the charity, this does not affect whether or how the Proposed Policy applies.

The Backgrounder provides that a “solicitation of support” is any statement or representation made for the purpose of seeking a voluntary donation, regardless of whether or not a donation receipt is issued. It indicates that costs associated with acknowledgement or thanking of donors are considered fundraising, unless the value and cost of the recognition is nominal and its purpose is merely to acknowledge the gift. Further, costs associated with stewardship initiatives (i.e. when a charity invests resources in relationships with past donors in the expectation or hope that they will make additional gifts) are fundraising (e.g. where a donor receives access to information, services, or privileges not

generally available to the public). In addition, it is fundraising where a charity offers a good or service other than to serve its beneficiaries and is not fulfilling its objects in offering the good or service, or where a charity offers a good or service to prompt or reward a donation. The Backgrounder also indicates that where a membership program provides an opportunity for people to join as a member upon making a donation, or where there is extensive use of donation incentives or premiums to promote joining as a member, such a program is a fundraising activity rather than a membership program.

4. Allocation of fundraising and charitable expenses

In order to demonstrate that an activity would have been undertaken without the solicitation of support, a charity must demonstrate that it meets either test A (the “Substantially All Test”) or test B (the “Four Part Test”):

Test A: Substantially All Test – where substantially all of the resources are devoted to the activity to advance an objective other than fundraising; or

Test B: Four Part Test – where *all* of the following apply to the activity:

1. The main objective of the activity was not fundraising, based on the resources devoted to fundraising in the activity, the nature of the activity, or the resources used to carry it out;
2. The activity does not include ongoing or repeated requests, emotive requests, gift incentives, donor premiums, or other fundraising merchandise;
3. The audience was selected for reasons other than their ability to give; and
4. Commission-based remuneration or compensation derived from the number or amount of donations is not being used.

The Proposed Policy indicates that where the Substantially All Test is met, all costs for the activity may be allocated as non-fundraising expenditures on the T3010A return. Where the Four Part Test is met, a portion of the costs for the activity may be allocated on the T3010A return as non-fundraising expenditures and a portion as fundraising expenditures.

The Backgrounder indicates that for the Substantially All Test, “substantially all” is considered 90% or more. Since the term “resources” is not defined in the *Act*, CRA considers it to include the total of a charity’s financial assets and everything the charity can use to further its purposes (e.g. its staff, volunteers, directors, premises, and equipment). Furthermore, the Backgrounder indicates that the

amount of resources devoted to an activity is determined by the content, prominence given to the material, and costs associated with carrying out the activity.

In relation to the Four Part Test, the Backgrounder provides extensive explanation on each part of the Four Part Test. For example:

- In relation to the first part of the Four Part Test, the Backgrounder indicates that (1) if the resources devoted to the fundraising component of the activity indicate that the main objective is fundraising, or (2) if the nature of the activity indicates that the main objective is fundraising, or (3) if the nature of the resources used to carry out the activity indicates that the main objective is fundraising, then the Four Part Test is not satisfied. In relation to the second criteria of whether the nature of the activity indicates that the main objective is fundraising, CRA in turn looks for the following features in such initiatives to see if there is a distinct objective other than fundraising in order to assess how much of the content relates to that objective of fulfilling a charity's purposes rather than fundraising: i) advancing the programs, services, or facilities offered by the charity; ii) raising awareness of an issue; iii) providing useful knowledge to the public or its stakeholders about the charity's work or an issue related to that work; and iv) being transparent and accountable for its practices by providing information about its structure, operations, or performance to the public or its stakeholders. Each of these criteria and features is explained in detail in the Backgrounder.
- In relation to the second part of the Four Part Test, CRA also reviews three aspects of an activity: i) are solicitations ongoing or repeated, ii) are requests emotive, or iii) are gift incentives, premiums, or other fundraising merchandize offered? Each of these aspects is explained in detail in the Backgrounder.

As indicated above, where the Four Part Test is met, a portion of the costs for the activity may be allocated on the T3010A return as non-fundraising expenditures and a portion as fundraising expenditures. The Backgrounder indicates that in determining what percentage of the activity should be attributed to each of the expenditure categories (i.e. fundraising and/or charitable, political activity, management and administration, or other category), costs of an activity should be allocated based on the cost of the resources used for the content attributable to each objective for which the activity was undertaken. It indicates that where input costs related to each objective will be discrete (e.g. different

staff persons within a charity prepare different parts of a publication), these costs can be reported as separate costs in accordance with how they are allocated by the charity in its bookkeeping. However, where costs will not be discrete (e.g. the costs of printing or mailing are for all the materials regardless of its objective), these costs should be allocated in proportion to the amount of content devoted to each objective.

5. Evaluation grid as an “initial tool”

The Proposed Policy indicates that in assessing the acceptability of a charity’s fundraising activities, CRA uses an evaluation grid as an “initial tool”. In this regard, the grid classifies a charity’s fundraising into one of five categories, ranging from acceptable to rarely acceptable, based on the ratio of fundraising costs to fundraising revenue during a fiscal period as follows:

- ♦ Rarely acceptable: More than 70% (charity nets less than 30%)
- ♦ Generally not acceptable: 50% to 70% (charity nets 30% to 50%)
- ♦ Potentially not acceptable: 35 to 50% (charity nets 50% to 65%)
- ♦ Generally acceptable: 20% to 35% (charity nets 65% to 80%)
- ♦ Acceptable: less than 20% (charity nets more than 80%)

The Backgrounder explains that an overriding consideration in evaluating fundraising by charities is their statutory obligation to comply with the disbursement quota in the Act. In this regard, the Proposed Policy and Backgrounder is not intended to relieve charities from its disbursement quota obligations, but is intended to assist charities in understanding the approach taken by CRA in dealing with the circumstances and issues associated with charity fundraising. Furthermore, the Backgrounder explains that as the relative cost of fundraising expenditures rises, and the cost percentage increases, the more likely it is to be considered unacceptable because of the presence of factors or conduct associated with prohibited fundraising and/or because of the absence of adequate efforts by the charity to ensure their fundraising activities comply with their legal obligations.

6. Other overriding factors

The Proposed Policy clarifies that the grid is only an *initial tool* in assessing the acceptability of a charity’s fundraising and CRA will examine the charity’s fundraising conduct before concluding that the charity’s fundraising is not acceptable. Approximately half of the Backgrounder provides a detailed explanation on each of these facts, which include:

- conduct that decreases the risk of unacceptable fundraising;
- conduct that increases the risk of unacceptable fundraising; and
- other circumstances.

CRA considers that the following conduct would decrease the risk of unacceptable fundraising by a charity:

- prudent planning processes;
- appropriate procurement processes;
- good staffing processes;
- ongoing management and supervision of fundraising practices;
- adequate evaluation processes;
- use made of volunteer time and volunteered services or resources; and
- disclosure of fundraising costs, revenues and practices.

CRA considers that the following conduct would increase the risk of unacceptable fundraising by a charity:

- sole-sourced fundraising contracts without proof of fair market value;
- non-arm's length fundraising contracts without proof of fair market value;
- fundraising initiatives or arrangements that are not well-documented;
- needless purchase, non-arm's length purchase or purchase not at fair market value, of fundraising merchandise;
- activities where most of the gross revenues go to contracted non-charitable parties;
- commission-based fundraiser remuneration or payment of fundraisers based on amount or number of donations;
- fundraisers receiving disproportionate compensation relative to non-fundraisers;
- total resources devoted to fundraising exceeding total resources devoted to program activities;
- misrepresentations in fundraising solicitations or disclosures about fundraising or financial performance; and
- combined fundraising and charitable program activity, where contracted to a party that is not a registered charity or that is compensated based on fundraising performance.



In a nut shell, CRA requires fundraising activities conducted by charities to be well planned, properly conducted, managed, supervised, and evaluated, with full and transparent disclosure to donors and the public, and by applying the appropriate amount of resources towards the activities. Each of the above conducts is explained in detail in the Backgrounder.

In addition to the above-noted conduct, the Proposed Policy also indicates that there are a number of circumstances faced by charities that may cause them to perform less well in an assessment of whether their fundraising is unacceptable by applying the above guidelines. As such, the Backgrounder indicates that CRA recognizes that, given the breadth and range of fundraising done by registered charities, in some circumstances applying a strict assessment may result in an unfair outcome. In those circumstances, CRA may permit higher costs or tolerate conduct that would otherwise be unacceptable. In this regard, the following are various circumstances that CRA may consider, with each circumstance being explained in detail in the Backgrounder:

- small charities or charities with limited appeal;
- charities that are investing resources in donor acquisition or other types of fundraising in which the return will not be realized in the same year in which the investment is made;
- charities whose main or major purpose is to make gifts to qualified donees, or to one or more registered charities and as a result have a different cost structure than charities that carry on their own activities;
- charities whose activities include lotteries or charitable gaming that is regulated provincially;
- charities engaging in cause-related marketing initiatives; and
- charities with extraordinary spending, relative to their size, on infrastructure to ensure compliance with this fundraising policy.

#### 7. Jurisdiction

The Proposed Policy indicates that federal authority over fundraising by registered charities is derived from legislative and common law sources. In this regard, the Proposed Policy indicates that most aspects of charities' operations are within provincial jurisdiction under sections 92(7) and 92(13) of *The Constitution Act*, 1867. However, the federal government is empowered to establish the federal tax system under section 91(3) of *The Constitution Act*, 1867. In turn, the Act sets out the scheme whereby registered charities are exempt from income tax and entitled to issue donation receipts. Eligibility for registration under the Act is based on meeting the common law definition of charity and abiding by the

provisions governing registered charities set out in the Act. In this regard, the Proposed Policy indicates that it deals with issues related to the federal regulation of fundraising by registered charities, and is not intended to address the various obligations of charities that exist owing to provinces exercising their jurisdiction over charities.

### **C. COMMENTS ON THE PROPOSED POLICY AND BACKGROUNDER**

In general, the initiative of CRA to develop guidance for registered charities on what constitutes acceptable fundraising activities is a welcome move in response to the growing demand from the public and the media for more accountability and transparency from charities. The Proposed Policy and the detailed Backgrounder demonstrate that CRA has invested a lot of time and effort in developing these documents. The inclusion of many examples in the Backgrounder is also helpful in assisting the reader to better understand the proposed requirements.

However, in spite of the detailed nature of the Backgrounder, these documents also raise many concerns in terms of how they may affect the fundraising activities of charities and how the Proposed Policy will be administered by CRA. The following are some examples of key areas of concern:

- Although the Backgrounder includes a lot of helpful information for the reader, the Backgrounder and the Proposed Policy also contain complicated legal concepts and requirements that may be difficult for registered charities to understand, let alone comply with. Although the Proposed Policy is only 8 pages in length, the Backgrounder is a 30-page document with which charities are also required to comply. While the Proposed Policy is generally easy to read, the Backgrounder is complicated and it is doubtful that volunteers or even staff of the average charity would be able to fully comprehend the complexities and intricacies contained in this document. For example, part 1 of the Four Part Test involves four assessment criteria, with the second criteria in turn involving four further criteria.
- Many of the requirements, determinative factors and criteria contained in the Proposed Policy and Backgrounder are highly subjective and at times vague. As such, there is the real possibility that inconsistencies might occur in the administration of the policy. An example is in relation to the application of the grid and the various over-riding factors. The Proposed Policy and Backgrounder indicates that the grid is only an “initial tool”, which is subject to CRA’s assessment of various factors involving the fundraising activities in question, namely 7 types of conduct that may decrease the risk

of unacceptable fundraising, 10 types of conduct that may increase the risk of unacceptable fundraising, and 6 categories of other circumstances. The assessment of these types of conduct and circumstances are highly subjective in nature and it is doubtful what safeguards, if any, could be put in place to ensure that they are assessed and applied consistently and appropriately by CRA.

- The ratio utilized by the grid appears to be arbitrary and without a clear underlying rationale. For example, it is difficult to understand why a ratio of 35% to 50% is potentially not acceptable, but a ratio of 20% to 35% is generally acceptable. Furthermore, the meaning of “fundraising revenue” is not entirely clear.
- The grid utilizes the ratio of fundraising costs to fundraising revenue on an *annual* basis. It is questionable whether such a ratio is an appropriate ratio to measure whether the fundraising activities of registered charity is acceptable. In this regard, the ratio does not take into account the fact that the nature of fundraising activities of charities varies widely, depending on their objects, structure and resources, etc. Take, for example, a donor who received materials from a charity on a capital campaign but did not make an immediate donation to the charity, yet mails a donation cheque to the charity in the following year. In that case, the fundraising costs in the first year may seem higher than it would have been because the donation received in the second year was not included in the calculation of the ratio. Perhaps a ratio that takes into account an averaging of the fundraising costs over a number of years may be more appropriate. Furthermore, the ratio does not take into account the ratio of fundraising costs or fundraising revenue versus the total operating cost or total revenue of the charity.
- The grid is based upon a ratio of fundraising costs in comparison to fundraising revenue. This is different from the disbursement quota under the Act, which allows a maximum of 20% of the previous year’s receipted income to be expended on fundraising and administrative costs. The Proposed Policy and Backgrounder do not provide a clear explanation of the relationship between the calculation of the ratio and the calculation of the disbursement quota. This lack of explanation could lead to confusion in the charitable sector concerning how the 80/20 disbursement quota requirement relates to the ratio for the grid.

- The Proposed Policy and Backgrounder also introduced a number of seemingly arbitrary tests and requirements which are, at times, vague. For example, it is not clear why the Backgrounder indicates that where the main objective of an activity is to fulfill one of a charity's purposes, and the activity would still have been undertaken without the fundraising component based on the other tests set out in the four part test, a charity may allocate *50% or more* of the costs for the activity to charitable expenditures and a portion to fundraising expenditures. It is not clear what this 50% test is based upon and how the allocation is to be calculated.
- The Proposed Policy indicates that the grid is only an *initial tool* in assessing the acceptability of a charity's fundraising and CRA will examine the charity's fundraising conduct before concluding that the charity's fundraising is not acceptable. It also indicates that given the breadth and range of fundraising done by registered charities, in some circumstances applying a strict assessment may result in an unfair consequence. As such, these documents indicate that in those circumstances, CRA *may* permit higher costs or tolerate conduct that would otherwise be unacceptable.

As a result, the grid is not determinative. However, this fact does not appear to have been clearly set out in the Proposed Policy or the Backgrounder. When a number-test is presented in a government policy, the general tendency is to rely on it as if it is the rule, without regard to the various over-riding factors and circumstances explained in the Proposed Policy and painstakingly elaborated in the Backgrounder. As such, if the grid is not a determinative test in any event, it is questionable what is achieved by having it. If the grid is retained, a very clear explanation and warning should be contained in the Proposed Policy to emphasize that the grid is not determinative, and that all factors involving the conduct of the fundraising activities should be reviewed in each case. In addition, clear guidance should be provided by CRA concerning how the various over-riding factors and circumstances are to be assessed and applied in order to ensure consistency of administration.

- One of the circumstances in which CRA is prepared to accept a higher ratio than that which is in the grid is with respect to charities whose main or major purpose is to make gifts to qualified donees, or to one or more registered charities and as a result have a different cost structure than charities that carry on their own activities. This would imply reference to charitable foundations. However, this has not been made clear in the Proposed Policy. The Backgrounder indicates that CRA may be prepared to accept higher fundraising costs for these charities, "provided these costs can be shown to be

reasonable given the charity's mandate, and that it can demonstrate costs are being adequately controlled.” Again, the application of such criteria is highly subjective and no guidance has been provided in the Backgrounder concerning what would be involved in order to meet these criteria. Furthermore, if CRA is prepared to accept a higher ratio for foundations, perhaps the Proposed Policy should simply set out another grid with a higher ratio that would apply to foundations instead.

- Lastly, although the Proposed Policy indicates that it deals with issues related to the federal regulation of fundraising by registered charities under the Act, it appears that the Proposed Policy and Backgrounder contain requirements and criteria that are not based upon any provisions in the Act, but instead reflect the common law requirements on charities in relation to fundraising. Examples of these requirements include prudent planning of fundraising activities, appropriate procurement process for fundraising activities, good staff processes for fundraising activities, no misrepresentations in fundraising solicitations or disclosures, etc. Although these are factors that directors of charities should address in order to conduct fundraising activities appropriately in discharging their fiduciary duties to manage and oversee the operation of charities, these criteria are by no means requirements under the Act. If CRA does not exercise oversight on compliance of these requirements in relation to other activities of a charity (e.g. prudent planning of a charitable program, good staff processes for charitable activities, hiring process of the CEO, etc.) as long as the charity otherwise complies with other requirements under the Act (e.g. having proper books and records, not carrying on unrelated business activities, meeting the disbursement quota requirements, etc.), it is questionable on what basis CRA can exercise oversight on compliance of these requirements in relation to fundraising activities.

In this regard, by imposing these requirements on charities' fundraising activities as part of CRA's policy, there is now some indication that CRA is moving away from being simply a regulator under a tax regime into becoming a regulator of charities as a whole, similar to what the Charity Commission does in the United Kingdom. One would have thought that such a change would have required sweeping changes at the legislators' level, not simply by the implementation of new policies at the CRA level as part of the tax regime under the Act.

To conclude, although more guidelines or regulations on fundraising activities by registered charities are welcomed initiatives, the charitable sector should be careful of what they ask for from CRA. There is a real concern that the current Proposed Policy and Backgrounder have gone too far in an attempt to regulate fundraising activities as a whole that is beyond the mandate and jurisdiction of CRA as a regulator of a tax regime under the Act. Furthermore, the Proposed Policy and Backgrounder, though very detailed, still contain many questions and concerns that will need to be addressed when CRA develops the final version of the policy.



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