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CRA RELEASES NEW FUNDRAISING GUIDANCE

By Terrance S. Carter[*]

A. INTRODUCTION

Canada Revenue Agency ("CRA") released its much anticipated new *Fundraising by Registered Charities Guidance: CG-013* (the "New Guidance")[1] on April 20, 2012, which updates and replaces CRA's earlier *Guidance (CPS-028): Fundraising by Registered Charities* ("*CPS-028*") that was released on June 11, 2009.[2] While the New Guidance represents a significant improvement over *CPS-028*, as it is much more readable and practical, the New Guidance is still a complex document that will require careful reading.

CRA has advised that the New Guidance does not represent a new policy position of CRA, but rather provides information on the current treatment of fundraising under the *Income Tax Act* ("ITA") and the common law. As such, the New Guidance will have a significant impact on current CRA audits, not just future audits. As well, the New Guidance applies to both receipted and non-receipted fundraising.

The New Guidance is intended to provide general advice for charities to follow and is based on the legal principle, established by case law, that fundraising must be seen as a necessary means-to-an-end for a charitable purpose, rather than an end-in-itself. In this regard, it is possible for a charity to engage in fundraising activities, provided that the fundraising is ancillary and incidental to the primary purpose of achieving the charity's purposes.

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[1] Canada Revenue Agency, *Fundraising by Registered Charities Guidance: CG-013* (20 April 2012) online: Canada Revenue Agency <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/fndrsng-eng.html>.

[2] Canada Revenue Agency, *Fundraising by Registered Charities Guidance CPS-028* (11 June 2009) online: Canada Revenue Agency <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cps/cps-028-eng.html>.

In addition to complying with the New Guidance, charities must continue to meet all other requirements of the ITA, including the 3.5% disbursement quota. The fundraising ratio referenced in the New Guidance (which remains the same as in *CPS-028*) results from data that is included in a charity's T3010 which is made available to the public on CRA's website. As such, it will be important for the board to review and approve the charity's T3010 before it is filed with CRA, given that the information contained in it can later be scrutinized by donors, and the press, as well as members of the public.

B. WHAT IS FUNDRAISING?

The New Guidance explains that, as a general rule, fundraising is any activity that includes a solicitation of present or future donations of cash or gifts in kind, or the sale of goods or services to raise funds, whether explicit or implied. Fundraising may include a single action, such as an advertisement, or a series of related actions, such as a capital campaign and includes direct activities, such as face-to-face canvassing, or indirect/related activities, such as researching and developing fundraising strategies and plans.

Fundraising activities can be carried out by either the registered charity or by another party acting on the charity's behalf, but does not include seeking grants, gifts, contributions or other funding from governments or other registered charities, or recruiting volunteers to carry out the general operations of the charity, or related business activities.[3] This means that not only are the costs associated with such requests not included in the fundraising expenses, but the resulting income from government and other charities is also not included in the income with regards to the fundraising ratio explained below.

1. <u>Examples of Fundraising Activities</u>

   a) The Sale of Goods or Services

   The sale of goods or services by a charity is always fundraising, unless the provision of the good or service serves the charity's beneficiaries, directly furthers a charitable purpose and is sold on a cost-recovery basis, or if it is a related business. For example, a youth group selling chocolate bars at a local shopping mall to support a trip that it is planning would be considered to be fundraising.

[3] For more information on Related Business see section C.5 below: "Fundraising that is an Unrelated Business."

b) Donor Stewardship

Donor stewardship occurs when a charity invests resources in relationships with past donors to solicit further donations. For example, an arts charity inviting only people who have given gifts above a certain amount to a private reception with the artists after a performance would be considered to be fundraising.

c) Membership Programs

For charities that are member-based, CRA considers membership programs to be fundraising where members receive material benefits beyond the simple right to vote and/or receive a newsletter.

d) Cause-related Marketing/Social Marketing Ventures

Cause-related marketing or social marketing ventures are activities where a charity works in collaboration with a non-charitable partner to sell goods and/or services. Most often, the expenses incurred related to the venture are paid by the non-charitable partner and the charity contributes its logo or other form of intellectual property.

For example, CRA would consider a charity creating a page on its website describing a partnership where a percentage of the sales of a restaurant on a certain day will be given to the charity and telling people how to participate to be fundraising.

e) Planning or Researching for Fundraising Activities

CRA considers planning or researching a fundraising campaign by a charity to be a fundraising activity. For example, a charity acquiring data on the demographics of a city in order to target those most likely to give as part of preparing for a door-to-door canvassing campaign, would be considered to be fundraising.

f) Donor Recognition

Donor recognition is the cost of gifts or acknowledgements to thank donors. The costs of gifts or other acknowledgements must be reported as fundraising expenses, unless they are of nominal value. Nominal value is a per-donor cost to the charity of the lesser of $75 or 10% of the donation. For nominal donor recognition gifts, the expenses must be reported as administrative.

C. WHEN IS FUNDRAISING NOT ACCEPTABLE?

The New Guidance states that the following conduct is prohibited and is grounds for revocation of a registered charity's status, imposition of sanctions or other compliance actions, or denial of charitable registration.

1. Fundraising that is a Purpose of the Charity

Registered charities cannot have fundraising as a collateral purpose. Where fundraising is a focus of the organization, being more than ancillary and incidental, it may be a collateral non-charitable purpose in and of itself. The New Guidance defines "ancillary and incidental" to mean subordinate or secondary to, and supporting of, the charity's purposes, and of relatively modest size.

2. Fundraising with a More than Incidental Private Benefit

Fundraising cannot result in an unacceptable or undue private benefit. A private benefit is any benefit provided to a person or organization that is not a charitable beneficiary, or a benefit to a charitable beneficiary that exceeds the bounds of charity. For example, non-arm's length fundraising contracts without proof of fair market value would be considered to be providing a more than incidental private benefit. As a general rule, incidental private benefits are acceptable where it is necessary, reasonable, and proportionate to the public benefit achieved.[4]

3. Fundraising that is Illegal or Contrary to Public Policy

Illegal fundraising includes anything that is criminally fraudulent, violates federal or provincial statutes governing charitable fundraising, charitable gaming, the use of charitable property, or consumer protection, or facilitates terrorism. Illegal fundraising also includes fundraising that is associated with illegal conduct, such as an abusive gifting tax shelter scheme.

Fundraising that is contrary to public policy includes failure to comply with legislation or some equally compelling public pronouncement evidencing public policy (eg. misleading solicitations that are contrary to consumer protection, i.e. *Competition Act*); or results in harm to public interest (eg. contract agreements between charities and third party fundraisers where there is misrepresentation to

[4] See the Guidance for more details on the meanings of "necessary", "reasonable", and "proportionate".

the public about whether donations go to charitable purposes or to pay for fundraising). For example, failing to disclose that 70% or more of funds raised are going to third party fundraising would be considered to be contrary to public policy.

4. Fundraising that is Deceptive

The charity should ensure that all representations made by it, and those acting on its behalf, are truthful, accurate, complete and timely. The charity must not misrepresent which charity will receive the donations, the geographic area in which the charity operates and the amount/type of work it undertakes, whether they have hired third-party fundraisers and how those fundraisers are compensated, and the percentage of funds raised by third parties that will go to charitable work. The charity must comply with the federal *Competition Act* (e.g., telemarketing) and any applicable provincial consumer protection legislation.

5. Fundraising that is an Unrelated Business

A charity selling goods or services on a regular basis or undertaking regular fundraising activities will have to ensure that it is only carrying on a related business. A related business is operated substantially (90%) by volunteers, or linked and subordinate to a charity's purposes.[5] For example, a charity that is registered to protect the environment and operates a coffee shop that is run entirely by paid staff would likely be considered to be engaging in an unrelated business because the activity would not be linked to its charitable purpose.

D. ALLOCATING FUNDRAISING EXPENDITURES

Registered charities must report fundraising expenditures (all costs related to any fundraising activity) on their annual T3010. Where some fundraising activities include content that is not related to fundraising, some of these costs may be able to be allocated to charitable activities, management or administrative activities, or political activities. However, the onus is on the charity to explain and justify the allocation.

[5] For more information on Related Business, see CRA Policy Statement CPS-019, *What is a Related Business?* Online: Canada Revenue Agency <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cps/cps-019-eng.html>.

1. 100% Allocation to Fundraising

Where 90% or more (“exclusively” or “almost exclusively”) of the activity is devoted to fundraising, a charity will have to allocate all of the costs to fundraising. The remaining content is considered to be ancillary and incidental to fundraising. To determine if an activity is exclusively (or almost exclusively) undertaken to fundraise, the fundraising content must be separated from the other content and proportions for each must be assessed. Also to be assessed are the resources devoted to each type of content and the prominence of the fundraising content in the activity.

The following activities are considered by CRA to be 100% fundraising expenditures:

- Activities involving participant-selection or audience targeting on their ability to give;
- Activities related to gaming (lotteries and bingos);
- Dissemination of information and activities that raise awareness about the charity;
- Infomercials and telemarketing;
- Branding or charity promotion through cause-related or social marketing;
- Activities that involve sports with participants being encouraged or expected to raise pledges; and
- Golf tournament and gala dinner fundraising.

2. No Allocation of Costs to Fundraising

Where it can be demonstrated that an activity would have been undertaken without the fundraising component, then 100% of the costs may be allocated to the applicable expenditure (eg. charitable, administrative, or political activity). To demonstrate this, the charity must be able to satisfy the “substantially all” test. When completing this test, a charity must separate fundraising content from other content. If substantially all (90% or more) of the activity advances an objective (or objectives) other than fundraising, then the costs may be allocated to the applicable content, with the fundraising being considered to be ancillary and incidental to the other activity or activities.

3. Pro-Rated Allocation of Costs

In some cases a charity may be able to pro-rate the allocation of costs of an activity between fundraising expenditures and charitable, management or administrative, and political activity expenditures.[6] However, the charity must be able to establish that less than 90% of the total content of the activity advances fundraising. If the fundraising expenditures account for more than 90%, then all expenditures must be allocated to fundraising. To determine if pro-rating is possible, the charity must again separate the fundraising content from other content. The onus is on the charity to produce the necessary accounting records to support the allocation.

The following are some examples of pro-rated allocation of costs given by CRA:

1. A charity that provides performance therapy for autistic children organizes an annual concert performance as part of its charitable activities, but the tickets are priced so that the charity earns a profit.

   This activity contains both charitable and fundraising content and thus the costs should be allocated between the two, such as concert costs as a charitable expenditure and the costs of advertising/invitations to fundraising.

2. A charity is registered to relieve poverty and organizes a march on Parliament Hill to call for a change in the law regarding Employment Insurance benefits and devotes about 20% of activity resources calling for donations and on fundraising merchandise.

   The march is a non-partisan political activity that falls within the charity's mandate and only uses the allowable amount of the charity's overall resources.

   The activity contains both political and fundraising content and thus 20% of the costs should be allocated to fundraising and 80% to political expenditures.

[6] The Guidance explains in considerable detail the characteristics associated with the different types of charitable, fundraising, management or administrative, or political content.

E. EVALUATING A CHARITY'S FUNDRAISING

The following are examples of some of the indicators that will generally be considered by CRA to be evidence of unacceptable fundraising. Each of the factors below is explained in more detail in the New Guidance and should be carefully studied, particularly with regards to suggestions by CRA concerning disclosure (see Section G. Best Practices below).

1. Resources Devoted to Fundraising are Disproportionate to Resources Devoted to Charitable Activities

   Where resources devoted to fundraising exceed the resources devoted to charitable activities, this is considered an indicator that fundraising has become a collateral non-charitable purpose. A charity's resources may be offset by substantial use of non-financial resources, such as volunteers. However, the use of volunteers in fundraising must still be accounted for as fundraising resources.

2. Fundraising Without an Identifiable Use or Need For the Proceeds

   Registered charities can only raise funds that are necessary to fulfil their mandates and must not fundraise simply because the charity has the opportunity to raise additional funds. As well, the charity must not misrepresent the financial need of the charity.

3. Inappropriate Purchasing or Staffing Practices

   The New Guidance provides several indicators of arrangements indicating a more than incidental private benefit, and fundraising that is contrary to public policy and/or deceptive. For example, paying more than fair market value for merchandise or services would be considered to be inappropriate purchasing.

4. Fundraising Activities Where Most of the Gross Revenues go to Contracted Third Parties

   This may result in a more than an incidental private benefit where a high percentage of fundraising proceeds go to a non-charitable party or parties.

5. <u>Commission-based Remuneration or Payment of Fundraisers based on Amount or Number of Donations</u>

This could result in a windfall profit for the fundraiser if the charity provides remuneration for fundraising on the basis of results rather than effort.

6. <u>Misrepresentations in Fundraising Solicitations or Disclosure about Fundraising Costs, Revenues or Practices</u>

Misrepresentations may arise from a failure to disclose information and may therefore create a false impression. Misrepresentations may also result from a statement by a charity, or someone on its behalf, that is inaccurate or deceptive.

7. <u>Fundraising Initiatives or Arrangements that are Not Well Documented</u>

A charity must properly document its fundraising activities to ensure that it can show that all legal obligations are being met. The ITA requires charities to maintain proper books and records.

8. <u>High Fundraising Expense Ratio</u>

CRA advises that a charity’s fundraising ratio can serve as a general self-assessment tool, although it is not determinative on its own. The fundraising ratio is the ratio of fundraising costs to fundraising revenue calculated on an annual basis. It is a global calculation for a fiscal period. However, a high fundraising ratio for an individual event may be an indicator of unacceptable fundraising.

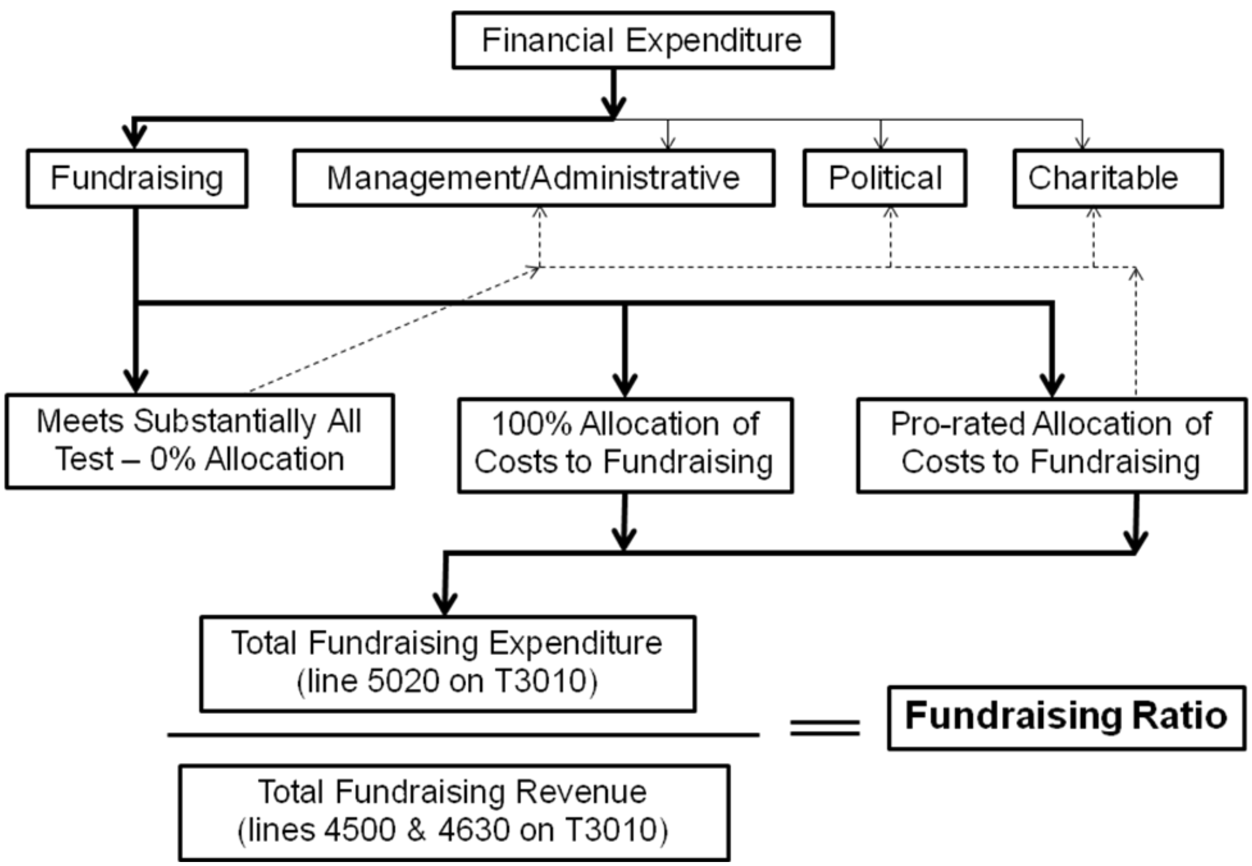
Fundraising revenues include amounts reported in the T3010 on line 4500 (receipted donations, regardless of whether these amounts can be traced to fundraising activity) and line 4630 (all amounts for which a tax receipt was not issued and that were generated as a direct result of fundraising expenses). Fundraising expenditures include all amounts reported on line 5020 as fundraising expenses in accordance with the Guidance.

The fundraising ratio will place a charity into one of three categories, which remains unchanged from *CPS-028*:

- **Under 35%:** unlikely to generate questions or concerns by CRA.

- **35% and above:** CRA will examine the average ratio over recent years to determine if there is a trend of high fundraising costs requiring a more detailed assessment of expenditures.
- **Above 70%:** this level will raise concerns with CRA. The charity must be able to provide an explanation and rationale for this level of expenditure, otherwise it will be considered unacceptable.

The following chart (prepared by the author, not by CRA) helps to show how a financial expenditure can be allocated in determining the fundraising expense portion of the fundraising ratio.



F. FACTORS THAT MAY INFLUENCE CRA'S EVALUATION OF A CHARITY'S FUNDRAISING

CRA recognizes that the charitable sector is very diverse and fundraising efforts will vary between organizations. CRA will look at a number of factors to evaluate a charity's fundraising activity that involves high fundraising costs. Examples of relevant case-specific factors include the following:

1. Small Charities

The size of the charity may have an impact on fundraising efficiency. For charities with revenues under $100,000, CRA will consider whether the fundraising costs are reasonable given the profile of the community the charity serves or with which it works.

2. Causes with Limited Appeal

Charities that advance causes with limited appeal, such as those conducting research into the prevention and cure of a relatively unknown disease, may encounter particular fundraising challenges and may experience increased fundraising costs for such causes.

3. Donor Development Programs

Donor development programs may mean that fundraising activities could result in financial returns only being realized in future years, representing more of a long-term investment. Donor development costs may decline over time as the charity, and its fundraising activities or donor base, become more established. If they do not, a charity must be able to justify the related costs.

4. Gaming Activities

Gaming activities, such as lotteries or bingos, are under provincial jurisdiction. Notwithstanding this, charities must still track their gaming activities as fundraising expenses. Provincial and territorial legislation governing gaming activities commonly considers cost to revenue ratios of 70% or higher to be acceptable. Therefore, while the costs and revenues of these gaming activities may result in a relatively high fundraising ratio, CRA has stated that it will generally be prepared to accept the higher ratios associated with these gaming activities, provided that they comply with the applicable provincial or territorial regulations as well as the ITA (eg. carrying on an unrelated business).

G. BEST PRACTICES

CRA advises that adopting the best practices, as outlined in the New Guidance and summarized below, may reduce the risk of CRA finding that a charity is engaging in unacceptable fundraising. The New Guidance describes the following best practices in more detail and, as such, should be carefully studied:

1. Prudent Planning Processes

   Costs should be reasonable and proportionate to the type and scope of activity in order to further the charitable purpose(s).

2. Adequate Evaluation Processes

   The charity`s fundraising performance should be evaluated against the New Guidance and the charity should consider developing its own criteria to gauge achievements against external standards.

3. Appropriate Procurement and Staffing Processes

   A charity should pay no more than fair market value for goods, services, salaries, and other compensation. It is a good practice to solicit bids from 3 or more potential suppliers before choosing one.

4. Managing Risks Associated with Hiring Contracted (Third Party) Fundraisers

   A charity should be able to demonstrate that fair market value was determined and have full disclosure so the public is not misled.

5. Ongoing Management and Supervision of Fundraising

   A charity should ensure that all conduct meets the charity's legal and regulatory obligations and exercise adequate control over the scope of fundraising.

6. Keeping Complete and Detailed Records Relating to Fundraising Activities

   Detailed records may include minutes of board or committee meetings where decisions on fundraising are made, or records of research to determine costs. The charity should document all processes undertaken before entering into contracts and have written copies of fundraising contracts.

7. Providing Disclosure about Fundraising Costs, Revenues, Practices, and Arrangements

   CRA recommends that charities provide truthful and accurate, accessible and timely public disclosure of all fundraising costs, revenues, practices and arrangements, so that members of the public and donors are not deceived or misled. CRA gives an example of including such information on the charity's website or in its annual report.

8. Maintaining a Reserve Fund Policy and Ensuring that Fundraising is for an Identified Use or Need

The size of a justifiable reserve fund will depend on a charity's particular situation. Some factors to consider include: the charity's typical annual expenditures; its size; long-term plans; donor base; projected revenue; current and projected economic conditions; contingencies; and known risks being faced. Although nothing is said in the New Guidance concerning what happens when a charity embarks on an endowment program, presumably if the endowment program can be justified as part of the charity's reserve fund policy, it should be acceptable. This may need to be clarified, though, by CRA in the future.

H. CONCLUSION

Although the New Guidance is a longer document than the earlier *CPS-028*, it is a much better organized resource tool and eliminates a lot of the confusion that had been experienced with *CPS-028* concerning allocation of fundraising expenses. However, the improvements to the New Guidance will likely create an expectation by CRA that charities should now be able to understand and comply with the New Guidance. This is reflected in the fact that the New Guidance uses more directive language of "should" as opposed to previous permissive language of "may" in many places within the New Guidance. As such, charities will want to carefully study and ensure compliance with the New Guidance on a go forward basis.

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