

Understanding CRA's New Guidance on Fundraising & How it Impacts Your Fundraising

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Overview

1. Summary of CRA's New Guidance on Fundraising
2. How the New Guidance on Fundraising Will Impact Your Fundraising

Note: For more information, see Charity Law Bulletin #169 "The Revised CRA Guidance on Fundraising: Improved But Still Challenging", at <http://www.carters.ca/pub/bulletin/charity/2009/chylb169.pdf>

Context for Guidance:

- Significant public and media pressure has been placed on CRA to more fully disclose internal guidelines
- Desire by CRA to educate and achieve consistency of inputs and transparency
- Majority of Canadians feel that fundraising costs should be capped in the 12-14% range
- However, no consistency of fundraising reporting of cost allocation

1. Summary of CRA's New Guidance on Fundraising

a) Background to Guidance

- On March 31, 2008, CRA released its proposed Policy on Fundraising for public consultation
- On June 26, 2008, CRA released a 30-page Background Information document explaining its proposed Policy on Fundraising
- After public consultation, Guidance (CPS-028): Fundraising by Registered Charities ("Guidance") was released on June 11, 2009, together with a 23 page Additional Information on the Guidance, which collectively need to be read as one document

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- The Guidance developed in response to a growing demand from the media and the general public for more accountability from charities concerning their fundraising
- The Guidance provides information on the current treatment of fundraising under the *Income Tax Act* ("ITA") and under the common law in order to provide guidance on:
 - Distinguishing between fundraising and other expenditures
 - Allocating expenditures for the purpose of reporting them on the T3010
 - Dealing with activities that have more than one purpose

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- Understanding how CRA assesses what is acceptable fundraising activity, what may preclude registration or what may result in a sanction, penalty or revocation
- CRA has advised that the Guidance does not represent a new policy position of CRA but rather provides information on the current treatment of fundraising under the ITA and the common law
- As such, the Guidance will have impact on current CRA audits, not just future audits

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- The Guidance is intended to provide general advice only
- The Guidance applies to all registered charities
- The Guidance applies to both receipted and non-receipted fundraising
- Charities must still meet their other obligations, and in particular the disbursement quota
- The Guidance is based on principles established by caselaw that fundraising must be a means-to-an-end, rather than an end-in-itself

- b) Fundraising and Charitable Purposes**
- All registered charities are required by law to have exclusively charitable purposes
 - CRA's position is that fundraising (either as a purpose or an activity) is not in and of itself charitable
 - As a result, CRA takes the position that direct fundraising costs cannot generally be reported as charitable expenditures on the T3010
 - However, CRA states that fundraising activities which are appended to activities primarily directed at achieving a charitable purpose may be able to be allocated between charitable and fundraising for purposes of reporting

- c) What is Fundraising?**
- In general, fundraising is any activity that:
 - Includes a solicitation of support for cash or in-kind donations;
 - Solicitations of support include sales of goods or services to raise funds;
 - Is part of the research and planning for future solicitations of support; or
 - Is related to solicitation of support (e.g. efforts to raise the profile of a charity, donor stewardship, or donor recognition)

- Fundraising includes activities carried out internally by the charity itself, such as fundraising employees or volunteers, or externally by someone acting on its behalf, such as telemarketing contractors
- Fundraising may include a single action, such as an advertisement, or a series of related actions, such as a capital campaign

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- Fundraising for the purpose of the Guidance does not include:
 - Requests for funding from governments
 - Requests for funding from other registered charities
 - Recruitment of volunteers
 - Related businesses
 - Fundraising to support terrorism (which is prohibited)

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- Donor recognition, as a form of solicitation of support, includes gifts or acknowledgements to thank donors, unless of nominal value (i.e. lesser of \$75.00 or 10% of the value of the donation)
- Donor stewardship, as a form of solicitation of support, occurs when a charity invests resources in relationships with past donors to prompt additional gifts, such as providing past donors with access to privileges not available to others, (e.g. an invitation to a private reception)

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- Sale of goods or services is always a solicitation of support except:
 - Where it serves the charities beneficiaries to fulfill a charitable purpose and is sold on a cost recovery basis, or
 - Is a related business (see CRA Policy Statement on Related Business)
- Membership programs will be considered to be a solicitation of support where membership requires a donation to join or where there is extensive use of donations incentive or premiums to recruit members

- d) Prohibited Conduct**
- The following conduct related to fundraising activities is prohibited and will be grounds for revocation of a registered charity's status, imposition of sanctions or other compliance actions, or for denial of charitable registration

1. Conduct that is illegal or contrary to public policy
 - Activities that are criminally fraudulent
 - Violates federal or provincial statutes governing charitable fundraising, charitable gaming, the use of charitable property, or consumers protection
 - Failure to take adequate care to avoid involvement in a third party tax shelter scheme
 - Failure to keep books and records to verify donations to the charity

- Activities that are contrary to recognized public policy
- Misrepresentation to the public about the cost of fundraising
- 2. Conduct that is a main, or independent purpose of the charity (even if only secondary)
 - i.e. Becomes a collateral purpose
- 3. Conduct that results in more than an incidental proportionate private benefit to individuals or corporations
 - e.g. A fundraising arrangement where a fundraiser enjoys a benefit exceeding fair market value

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- 4. Conduct that is deceptive
 - A charity is to ensure representation made by it is a fair, truthful account and complete
 - A charity is responsible for misleading statements whether the charity's conduct is intentional or negligent
 - A charity must not misrepresent
 - o What charity will receive the donation
 - o The geographic area where the charity operates and the amount and type of work
 - o The percentage of funds that will go to charitable work

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- e) Allocation of Fundraising Expenses**
- In general, charities are to report on their T3010 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 the solicitation of support

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- This does not apply to asking for funding from governments or other charities
- However, it does apply to marketing and sale of goods or services not within the charities own charitable purposes, whether or not donation receipts are issued
- In order to demonstrate that an activity would have been undertaken without solicitation of support, a charity must demonstrate that it satisfies either Test A (The "Substantially All Test") or Test B (The "Four Part Test")

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- **Test A: The "Substantially All Test"**
 - Where Test A ("Substantially All Test") is met, all costs of the activity may be allocated as non-fundraising expenditures on the T3010 return, either as charitable, administrative or political
 - The "Substantially All Test" is met where "substantially all" of the activities advance an objective other than fundraising
 - "Substantially all" is considered to be 90% or more

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- Generally, the determination will be the proportion of the fundraising content to the rest of the activity, as well as the resources devoted to it
- "Resources" include the total of a charity's financial assets, as well as everything the charity can use to further its purposes (e.g. its staff, volunteers, directors, premises, and equipment)
- 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

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• **Test B: The "Four Part Test"**

- Where Test B ("Four Part Test") is met, a portion of the costs for the activity may be allocated on the T3010 return as non-fundraising expenditures as either charitable, administrative or political, and a portion as fundraising expenditures
- The "Four Part Test" is met where the answers to all of the following four questions is "no"

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1. Was the main objective of the activity fundraising?
2. Did the activity include ongoing or repeated requests, emotive requests, gift incentives, donor premiums, or other fundraising merchandise?
3. Was the audience for the activity selected because of their ability to give?
4. Was commission-based remuneration or compensation derived from the number or amount of donations used?

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- The Guidance provides extensive explanation and examples on each part of the "Four Part Test"
- Specifically, question 1 of the "Four Part Test" itself involves two assessment criteria, with the second criteria in turn involving four separate factors to consider
- As well, question 2 of the "Four Part Test" involves three separate assessment criteria
- As such, the "Four Part Test" can be very challenging to work through

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- Even if an activity would not have been undertaken without solicitation of support, charities may still be allowed to allocate a portion of the costs other than to fundraising if the activity furthers its charitable programs,
 - e.g. Charity promotes an event where revenues are based on the charity's work with its beneficiaries, such as a concert performance performed by autistic children

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f) Evaluation of Fundraising Activities

- Fundraising revenues include amounts reported in the T3010 on line 4500 (receipted donations) and line 4630 (all revenue generated as a direct result of fundraising expenses)
- Fundraising expenditures include amounts reported on line 5020 as fundraising expenses in accordance with the Guidance
- CRA recognizes that the charitable sector is very diverse and fundraising efforts will vary between organizations

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- CRA will look at a number of factors to evaluate a charitable fundraising activity
- CRA has identified four types of factors to assist with the assessment
 1. Fundraising Ratio and Approach of CRA
 2. Basic Considerations
 3. Best Practice Indicators
 4. Area of Concern Indicators

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1. Fundraising Ratio and Approach of CRA

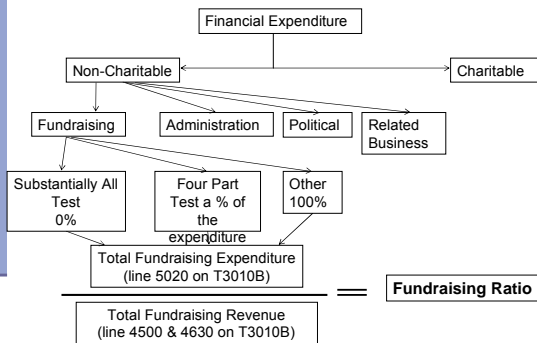
- One factor is the ratio of fundraising costs to fundraising revenue calculated on an annual basis
- Fundraising ratio provides a general guidance only and is not determinative on its own
- Fundraising ratio is totally distinct from the 80/20 disbursement quota, although elements of it overlap in the ratio

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- The fundraising ratio will place a charity in one of three categories
 - 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 not be acceptable

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FUNDRAISING RATIO FLOWCHART



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- 2. Basic Considerations that CRA will look at in assessing a charity's fundraising activities
 - The size of the charity which may have an impact on fundraising efficiency
 - Causes with limited appeal which could create particular fundraising challenges
 - Donor acquisition and planned giving campaigns which could result in situations where the financial returns are only realized in later years

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- 3. Best Practices Indicators that decrease the risk of CRA finding unacceptable fundraising
 - Prudent planning processes
 - e.g. Where the charity researches anticipated costs and revenues
 - Appropriate procurement processes
 - e.g. Solicit bids from three or more potential suppliers or issuing RFP's
 - Good staffing processes
 - e.g. Setting compensation that is appropriate compared to other employees of the charity in light of respective responsibilities
 - e.g. Should avoid performance evaluation based solely or excessively on performance or results

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- Ongoing management and supervision of fundraising practice
 - e.g. Establish and implement a fundraising policy
- Adequate evaluation processes
 - e.g. At a minimum regularly assess its fundraising performance compared to CRA Guidance
- Use made of volunteer time and volunteered services or resources
 - Demonstrates a commitment to minimize the expenditure allowable for the fundraising activity

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- Disclosure of fundraising costs, revenues and practice (including cause-related or social marketing arrangements)
 - CRA expects charities to provide complete public disclosure for all fundraising costs and revenue
 - Generally greater disclosure required for solicitation to the public than to members
 - The higher the cost for a fundraising activity, the more there is a need for disclosure
 - Information must be accessible (e.g. the web and annual reports) and accurate, (e.g. the best information available)

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- A charity may need to consider disclosing information before, during and after a fundraising initiative, which information might include:
 - Estimated fundraising costs and revenues in its annual budget
 - Whether fundraisers are receiving commission or other payment based on the number or amount of donation
 - The general terms of the fundraising contract, including the method of compensation and anticipated costs and revenues

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- How internal fundraisers are assessed and compensated
- The costs and revenues for specific types of fundraising or campaigns within a fiscal period (after completion)
- Cause-related ventures are not subject to this policy, provided that more than 90% of the costs are borne by a non-charitable partner and all costs and revenues are adequately disclosed (excluding costs of intellectual property)

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- 4. Areas of Concern Indicators that could cause CRA to further review a charity's fundraising activities
 - Sole-sourced fundraising contracts without proof of fair market value
 - May lead to excessive and disproportionate private benefit
 - Non-arm's length fundraising contracts without proof of fair market value
 - May result in undue benefit
 - Fundraising initiatives or arrangements that are not well-documented
 - e.g. No minutes of board meeting or other meetings where fundraising contracts were approved
 - e.g. No documentation on any procurement processes

- Fundraising merchandise purchases that are not at arms length, not at fair market value, or not purchased to increase fundraising revenue
 - e.g. Must be able to show that gift incentives or donor premiums will result in increased revenue
- Activities where most of the gross revenues go to contracted non-charitable parties
 - e.g. Must be able to show steps to determine the fair market value

- Commission-based fundraiser remuneration or payment of fundraisers based on amount or number of donations
 - Raises concern about disproportionate or excessive private benefit
 - e.g. Compensation based on calls completed or contacts made is preferable
- Total resources devoted to fundraising exceeding total resources devoted to program activities
 - Otherwise concern by CRA that fundraising may become a collateral purpose
 - Where discrepancies in costs of different functions occur, the cost of a particular function should be shown to be reasonable, but merely showing that costs of fundraising are at FMV is not sufficient

- Misrepresentations in fundraising solicitations or disclosures about fundraising or financial performance
 - e.g. Misrepresentation may result from either intentional conduct or an omission of information that creates a false impression
- Each of the above factors are explained in considerably more detail in the Guidance and must be carefully studied, particularly with regards to expectations by CRA concerning disclosure

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g) Lingering Concerns About Guidance

- Many of the requirements, factors and criteria contained in the Guidance are open to subjective interpretation and accordingly, there may be inconsistencies in the administration of the Guidance and resulting audits of charities
- The fundraising ratio is based on a ratio of fundraising costs and revenue calculated on an annual basis, but does not take into account the fact that the nature of fundraising activities of charities varies widely – perhaps a rolling average approach would have been more appropriate

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- The Guidance is complicated and may be difficult for charities to understand and comply with at a practical level
- The fundraising ratio used is different from the disbursement quota under the ITA – the proposed Guidance should explain how the elements in the ratio relate to the calculation of disbursement quota
- Greater focus is required on disclosure of fundraising costs, revenues and practices which may impact the ability to attract donors
- Not clear whether disclosure is to be done after each fundraising campaign in addition to doing so for the fiscal year

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2. How the New Guidance on Fundraising Will Impact Your Fundraising

a) 2008 AFP Reaction to CRA Earlier Draft

- AFP has worked to ensure sector consensus and a unified response to the initial draft Policy on Fundraising
- AFP formed a coalition with Imagine Canada, CAGP, HCCC and numerous other organizations to review the policy documents and offer suggested changes
- AFP, as a member of that coalition, worked to improve and enhance the policy

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b) AFP Accomplishments to Date

- AFP was generally encouraged with the changes found in the final version of the Guidance
- The final Version:
 - Revises the previous fundraising ratio and made it less rigid and less reliant on numbers and raw data
 - Incorporates many of the AFP/coalition's other recommendations for improvement, such as a radical change in overall tone
 - Acknowledgement that further refinement of the Guidelines is required

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c) Reality check:

- The fundraising ratio still does not allow anecdotal explanation of cost factor variances
- The document excludes some revenue and expense categories (i.e. grant or United Way revenue)
- The document is complex and intimidating: requires expertise to interpret and file

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- However, revised Guidance has received positive media attention
- CRA described the consultation process as a success and promised continued collaboration
- The Guidance granted AFP, Imagine Canada and others the opportunity to work in a collaborative way that produced positive results

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d) Next Steps

- Continue sector collaboration
- Collect and compile sector feedback
- Seek to improve existing Guidance
- Seek to educate on the distinction between fundraising cost factors and fundraising legitimacy
- Publicize our work with CRA as a benefit to our membership

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3. Q & A

a) Questions from the Moderator

- Will the disclosure expectations be per program or consolidated?
- Why is grant revenue not considered fundraising revenue?
- What is meant by disproportionate private benefit?
- Are these positive or negative changes?
- How does the fundraising ratio relate to the disbursement quota?

b) Questions from Participants

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