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Complying with CRA's New Fundraising Guidance (Revised 2012)

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OVERVIEW OF TOPICS

1. Introduction
2. What is Fundraising?
3. When is Fundraising Not Acceptable?
4. Allocating Fundraising Expenditures
5. Evaluating a Charity's Fundraising
6. Factors that May Influence CRA's Evaluation of Fundraising
7. Best Practices for Managing Fundraising

A. INTRODUCTION

- On June 11, 2009, CRA introduced Guidance (CPS-028): Fundraising by Registered Charities
- The charitable sector was asked to provide feedback on this Guidance and as a result CRA has recognized the need to make the Guidance more practical
- CRA's review of the Guidance has resulted in a new draft Fundraising Guidance
- However, the Guidance is not yet available for distribution

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- This presentation consists of a preview of the new Guidance that is likely to be released in early March 2012
- The new Guidance is a significant improvement but is a longer document at 39 pages compared to 31 pages
- It will be essential to read the whole document, including Appendices A to D
- Although much improved, the new Guidance is still a complex document and will therefore require careful reading

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- 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 *Income Tax Act* ("ITA") and common law
- As such, the Guidance will have impact on current CRA audits, not just future audits
- The Guidance is intended to provide general advice for charities to follow and is based on legal principles established by caselaw that fundraising must be seen as a necessary means-to-an-end for a charitable purpose, rather than an end-in-itself
- The Guidance will apply to all registered charities and to both receipted and non-receipted fundraising

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- Charities must still meet their other obligations, including the 3.5% disbursement quota
- An organization carrying out unacceptable fundraising may result in denial of charitable registration or, for registered charities, sanctions or even revocation of charitable status
- The fundraising ratio referenced in this Guidance forms part of a charity's T3010 that is made available to the public on the web
- It is therefore important for the board of a charity to review and approve the T3010 for a charity before it is filed with CRA

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B. WHAT IS FUNDRAISING?

- In general, fundraising is any activity that includes 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
- Includes activities carried out internally by the charity itself, such as volunteers and staff, or externally by anyone acting on its behalf, such as telemarketing contractors
- May include single action, such as an advertisement, or a series of related actions, such as a capital campaign

- Includes direct activities, such as face-to-face canvassing, or indirect/related activities, such as researching and developing fundraising strategies and plans
- For the purpose of the Guidance, fundraising does not include (i.e. to be excluded from revenue and expenses):
  - Seeking grants, gifts, contributions, or other funding from other charities or government
  - Recruiting volunteers (except for fundraising volunteers)
  - Related business activities (see slide #20 for details)

Examples of Fundraising Activities

1. The sale of goods or services
   - Ex: A youth group sells chocolate bars at a local shopping mall, and will use the money it makes to support a trip it is planning
   - But excludes providing goods or services that serve the charity's beneficiaries, directly further a charitable purpose, and are sold on a cost-recovery basis
   - Also excluded is a related business

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2. Donor stewardship
   – Occurs when a charity invests resources in relationships with past donors to solicit further donations
   – Ex: An arts charity invites only people who have given gifts above a certain amount to a private reception with the artists after a performance
3. Membership programs
   – Where material benefits beyond the right to vote and/or receive a newsletter
   – Ex: Membership programs that require a donation to join or where there is extensive use of donation incentives or premiums to promote joining as a member

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4. Cause-related marketing/social marketing ventures
   – Collaboration with a non-charitable partner to sell goods and 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
   – Ex: A charity creates a page on its Webpage describing the 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

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5. Planning or researching for fundraising activities
   – Ex: As part of preparing for a door-to-door canvassing campaign, the charity acquires data on demographics of a city for targeting those most likely to give
6. Donor recognition
   – 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 $75 or 10% of the donation (whichever is less)

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C. WHEN IS FUNDRAISING NOT ACCEPTABLE?

- The following conduct will be prohibited and will be grounds for revocation of a registered charity's status, imposition of sanctions or other compliance actions, or denial of charitable registration
  a) Fundraising that is a purpose of the charity (a collateral non-charitable purpose)
  b) Fundraising that delivers more than an incidental private benefit
  c) Fundraising that is illegal or contrary to public policy
  d) Fundraising that is deceptive
  e) Fundraising that is an unrelated business

a) 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 end or purpose in and of itself
- "ancillary and incidental" means subordinate or secondary to, and supporting of the charity's purposes, and of relatively modest size

b) Fundraising with a More Than Incidental Private Benefit

- Fundraising cannot result in an unacceptable or undue private benefit (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)
- Ex: Non-arm's length fundraising contracts without proof of FMV
- Incidental private benefits will be acceptable where it is necessary, reasonable, and proportionate to the public benefit achieved

- Necessary = legitimately and justifiably resulting from actions, or steps/consequences to an action, that directly contribute to the charitable purpose or to achieving the charitable purpose
  - Or results from the operation of a related business
- Reasonable = relates to the need to achieve the charitable purpose and is no more than necessary
  - Must be fairly and rationally incurred (ex: fair market value)
- Proportionate to the public benefit = public benefit is predominate, costs are proportionate to the funds expected to be raised/used for charitable ends

c) Fundraising That is Illegal or Contrary to Public Policy

- Illegal fundraising will include 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
- Also will include fundraising that is *associated* with illegal conduct, such as an abusive gifting tax shelter scheme

- Fundraising that is contrary to public policy will include:
  - Failure to comply with legislation or public pronouncement (ex: misleading solicitations that are contrary to consumer protection, i.e. *Competition Act*)
  - Results in incontestable harm to public interest (ex: contract agreements between charities and third party fundraisers where there is misrepresentation to the public about whether donations go to charitable purpose or to pay for fundraising)
  - e.g., failing to disclose that 70% or more of funds raised goes to third party fundraising

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d) 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 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 provincial consumer protection legislation

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e) 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 by volunteers; or
  - Linked and subordinate to a charity's purposes
- Ex: To help fundraise, a charity opens a coffee shop that will be run entirely by paid staff. This is likely an unrelated business because the activity is not linked to the charitable purpose
- For more information, see CRA Policy Statement CPS-019, *What is a Related Business?*

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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
- Onus is on the charity to explain and justify the allocation
- The following are CRA's guidelines for allocation:
  - 100% allocation to fundraising
  - No allocation of costs to fundraising
  - Pro-rated allocation of costs

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100% Allocation to Fundraising

- Where 90% or more of the activity was 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, separate the fundraising content from the other content and assess proportions, resources devoted to and prominence given to charitable, fundraising, management or administrative, and political content

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- Activities that will be considered 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 expected to raise pledges
  - Golf tournament and gala dinner fundraising

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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 will be allocated to the applicable expenditure (ex: charitable, administrative, or political activity)
- To demonstrate this, the charity must be able to satisfy the “substantially all” test
  - If substantially all (90% or more) of the activity advances an objective (or objectives) other than fundraising
  - When completing this test, a charity must separate fundraising content from other content

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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
- But must be able to establish that less than 90% of the total content of the activity advances fundraising
- If more than 90%, then all expenditures must be allocated to fundraising
- To determine if pro-rating is possible, must separate the fundraising content from other content
- The onus is on the charity to produce the necessary accounting records to support the allocation

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- The Guidance explains in considerable detail the characteristics associated with the different types of charitable, fundraising, management /administrative, or political content
- Charitable content of an activity generally:
  - Will directly further the charity's charitable purposes;
  - Focuses primarily on beneficiaries or potential beneficiaries of the charity's programs, services, or facilities, not current or prospective donors; and
  - Is not, as a rule, prepared and/or delivered by individuals or organizations whose skills and usual responsibilities are to fundraise

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- Fundraising content of an activity may include:
  - Implied or explicit requests for donations of cash or gifts in kind;
  - Information about how to make a donation, including planned giving;
  - The provision of goods and services that do not directly further the charity's charitable purpose
  - Activities, such as sports events, where participants are encouraged or expected to raise pledges
  - Advertising to promote events that involve fundraising; and
  - The management and administration of fundraising activities (ex: planning and research for future fundraising)

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- Management and administrative content will tend to relate to:
  - Arranging, holding and reporting on board meetings;
  - Bookkeeping, accounting, auditing, personnel, and other administrative services;
  - Purchasing supplies and equipment and occupancy costs for administrative offices; or
  - Applying for grants or other types of government funding, and/or for gifts from other qualified donees
- Political content
  - An activity that directly or indirectly attempts to retain, change, or oppose a law in Canada or abroad, or sways public opinion on social issues
  - See CRA Policy Statement CPS-022 Political Activities

- Examples of pro-rated allocation of costs:
  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 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 to call for donations and on fundraising merchandise
   - The march is a non-partisan political activity that falls within the charity's mandate and uses only the allowable amount of the charity's overall resources
   - This activity contains both political and fundraising content and thus 20% of the costs should go to fundraising and 80% to political

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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:
  - Resources devoted to fundraising are disproportionate to resources devoted to charitable activities
    - 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
  - Fundraising without an identifiable use or need for the proceeds
    - Must also not misrepresent the financial need of the charity

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- Inappropriate purchasing or staffing practices
  - Paying more than FMV for merchandise or services
- Fundraising activities where most of the gross revenues go to contracted third parties
  - This may result in a more than an incidental private benefit
- Commission-based fundraiser remuneration or payment of fundraisers based on amount or number of donations
  - Could result in windfall profit for the fundraiser

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- Misrepresentations in fundraising solicitations or disclosure about fundraising costs, revenues, or practices
  - Failure to disclose information that creates a false impression
  - Results from a statement by a charity, or some-one on its behalf, that is inaccurate or deceptive
  - Can occur in a charity's reporting on its fundraising after solicitation
- Fundraising initiatives or arrangements that are not well documented
  - Charity must keep records that properly documents its fundraising activities
- High fundraising expense ratio
  - More detail provided in the slides below

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- Each of the above factors are explained in more detail in the Guidance and must be carefully studied, particularly with regards to suggestions by CRA concerning disclosure (see Best Practices section below)
- It is important to note that a charity's fundraising ratio can serve as a general self-assessment tool, although it's 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

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- It is totally distinct from the 3.5% disbursement quota, although elements of it overlap in the ratio
- 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 will include all amounts reported on line 5020 as fundraising expenses in accordance with the Guidance

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- The fundraising ratio will place a charity into 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
- See logic chart on next page (not by CRA)

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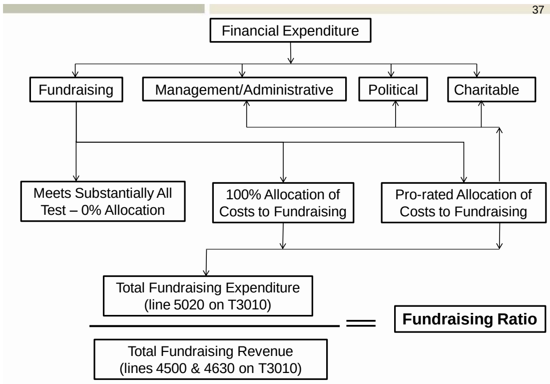

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F. FACTORS THAT MAY INFLUENCE CRA'S EVALUATION OF A CHARITY'S FUNDRAISING

- 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 charitable fundraising activity that involves high fundraising costs
- Examples of relevant case-specific factors include the following:
  - The size of the charity, which may have an impact on fundraising efficiency (i.e. revenues under $100,000)

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- Causes with limited appeal which could create particular fundraising challenges, i.e.
  - Cause has limited appeal among the general public
  - Higher fundraising costs are a direct result of its cause
  - The fundraising activity is the most efficient and effective option
  - The associated costs are adequately controlled
- Donor development programs where fundraising activities could result in financial returns only being realized in future years (long-term investments)
- Gaming activities, such as lotteries or bingos, where it's commonly considered acceptable to have cost to revenue ratios of 70% or higher

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G. BEST PRACTICES FOR MANAGING FUNDRAISING

- Adopting best practices may decrease the risk of CRA finding that a charity is engaging in unacceptable fundraising
- The Guidance describes the following best practices in further detail:
  - Prudent planning processes
    - Costs should be reasonable and proportionate to the type and scope of activity to further the charitable purpose(s)
  - Adequate evaluation processes
    - Evaluate fundraising performance against the Guidance and develop own criteria to gauge achievements against external standards

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- Appropriate procurement and staffing processes
  - Pay no more than FMV for goods, services, salaries, and other compensation
  - Solicit bids from 3 or more potential suppliers
  - Determine the reasonable compensation of in-house fundraising staff
- Managing risks associated with hiring contracted (third party) fundraisers
  - Demonstrate FMV was determined and have full disclosure so the public is not misled
- Ongoing management and supervision of fundraising
  - Ensure all conduct meets charity’s legal and regulatory obligations
  - Exercise adequate control over scope of fundraising

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- Keeping complete and detailed records relating to fundraising activities
  - Minutes of board or committee meetings where decisions on fundraising are made
  - Records of research to determine costs
  - Document all processes undertaken before entering into contracts
  - Written copies of fundraising contract
- Providing disclosures about fundraising costs, revenues, practices and arrangements
  - CRA expects charities to provide complete public disclosure for all fundraising costs and revenue, and in particular to donors and members of the public

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- Disclosure must be accurate, accessible, and timely
- Some evidence of a charity's commitment to disclosure:
  - Public disclosure of fundraising costs and revenues in financial information released
  - Adopt disclosure policies
  - Train staff/volunteers making solicitations on appropriate fundraising representations and pre-approve soliciting scripts and materials that will be used by them

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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 donations
  - 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 marketing ventures are not subject to the best practices relating to disclosure outlined above, 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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– Maintain a reserve fund policy and ensuring that fundraising is for an identified use or need
  - The size of a justified reserve policy will depend on a charity's particular situation
  - Factors to consider include:
    - Its typical annual expenditures;
    - Its size;
    - Its long-term plans;
    - Its donor base;
    - Its projected revenue;
    - Its current and projected economic conditions;
    - Contingencies; and
    - Known risks being faced.

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