
THE OTTAWA REGION CHARITY LAW SEMINAR

Ottawa – February 11, 2009

The Impact of the New CRA Proposed Fundraising Policy for Charities

By Terrance S. Carter, B.B., LL.B., Trade-mark Agent

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INTRODUCTION

- On March 31, 2008, CRA released a proposed policy on fundraising
- On June 26, 2008, CRA released a 30-page background information document explaining the proposed policy
- The policy was developed in response to a growing demand from the media and the general public for more accountability from charities on their fundraising activities

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- The policy provides information on the use of resources for fundraising and the limits imposed by law and explains:
 - How to promote transparency of charitable finances through accurate disclosure of fundraising costs and revenues
 - How to distinguish between fundraising and other expenditures
 - How to classify and report activities intended both to raise funds and advance charitable programming

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- When fundraising activities may preclude registration or result in revocation of registration
- What factors are considered by CRA when assessing whether the fundraising undertaken puts a charity’s registration status at risk
- Consultation closed on August 31, 2008
- Final form of policy expected in late February 2009
- CRA has advised that the policy, once released, does not represent a new policy position of CRA but simply a confirmation of their existing policy
- As such, the policy will have impact on current audits, not just future audits

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GENERAL PRINCIPLES

- The policy applies to all registered charities
- Applies to both receipted and non receipted fundraising
- The policy is based on principles established by caselaw that fundraising must be a means-to-an-end, rather than an end-in-itself, even where fundraising is a stated purpose of a charity

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DIFFERENCES BETWEEN FUNDRAISING AND CHARITABLE PURPOSES OR ACTIVITIES

- All registered charities are required by law to have exclusively charitable purposes
- The ITA does not define what is charitable
- Courts have determined that fundraising is not charitable in-and-of-itself
- Therefore, fundraising costs generally cannot be reported as charitable expenditures and fundraising activities are not normally treated as advancing a charity's charitable purpose

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- Not every action of a registered charity is required to be in-and-of-itself charitable
- Charities can fundraise in support of their charitable purposes even though fundraising activities, taken alone, would not necessarily be charitable
- Certain fundraising activities are specifically permitted under the ITA even though they are not charitable activities (e.g. fundraising through related business where it is substantially run by volunteers, or fundraising to disburse funds to qualified donees that are not registered charities)

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PROHIBITED CONDUCT

- Two prohibited fundraising activities not dealt with in this policy
 - To fundraise as an unrelated business
 - To fundraise, or otherwise make its resources available, to support terrorism
- The following prohibited conduct related to fundraising activities 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

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- b) Conduct that has become a main, prevailing, or independent purpose of the charity
- c) Conduct that results in excessive or disproportionate private gain by individuals or corporations
- 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 very detailed explanation on each of the areas of prohibited conduct is provided in CRA's background document

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- a) Conduct that is illegal or contrary to public policy
 - A fundraising activity can be illegal where
 - It is contrary to the ITA or other statutory provisions, i.e. provincial fundraising legislation
 - It facilitates or advances an illicit gifting arrangement or involves improper issuance of donation receipts
 - This applies where the fundraising activity is not in itself illegal, but is associated with illegal conduct - where a charity knows, or ought to have known, that through its fundraising it is furthering illicit practices or transactions (e.g. a charity fails to ensure the integrity of a third party tax shelter scheme marketed to multiple donors)

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- A fundraising activity is contrary to public policy where
 - It results 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)
 - It enters into fundraising contracts that result in the public being misled about the use of donations
 - A fundraising solicitation does not comply with Canadian Radio-television and Telecommunications Commission directives, the Commission's telemarketing rules, or other established government policy

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- b) Conduct that has become a main, prevailing, or independent purpose of the charity
 - Fundraising activities will not be a main or 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

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- 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 pursuing charitable objects
 - 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)

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- 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**
- 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.)
 - Charities cannot undertake fundraising activities that impair the fundraising efforts of other charities

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ALLOCATION OF FUNDRAISING EXPENSES VS. CHARITABLE EXPENSES

- In general, charities are to report on their T3010A return (as well as the new T3010B for year ends after January 1, 2009) 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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- 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)
 - 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)

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- 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 – includes:
 - Costs associated with acknowledgement or thanking donors, unless the value and cost of the recognition is nominal and its purpose is merely to acknowledge the gift
 - 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 - e.g. where a donor receives access to information, services, or privileges not generally available to the public

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- Research and planning for future solicitations of support
- Goods and services to prompt or reward a donation
- Sale of goods and services other than to serve the charity’s beneficiaries and is not fulfilling its objects
- A membership program 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

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- 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

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- Test A (Substantially All Test)
 - “Substantially all” is considered 90% or more
 - “Resources” includes 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)
 - 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 A Examples**

1. A ¼ page solicitation for donations for a church project is included in a 4-page leaflet for a church service along with staff contact information and the schedule of church services.
 - None of the costs of the leaflet (staff time, paper, printing) need to be attributed as fundraising

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2. A charity broadcasts a T.V. program featuring a repeated or continuing fundraising solicitation across the bottom of the screen. Based on time that it appears and space used, the solicitation uses less than 10% of the resources used for the program
 - However, some or all of the expenditures must be reported as fundraising due to the prominence of the solicitation content

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• **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

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• **Test B (Four Part Test)**

- The background document provides extensive explanation on each part of the Four Part Test
- Specifically, Part 1 of the Four Part Test involves three assessment criteria, with the second criteria in turn involving four further criteria
- As well, Part 2 of the Four Part Test involves three aspects of an activity
- As such, the Four Part Test can be very challenging

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• **Test B Examples**

– **Examples where the activity’s main objective is not fundraising (Part 1 of Test B) include those undertaken:**

- 1. To advance the programs or services the charity offers (e.g. leaflet promoting participation in a program is distributed door-to-door)**
- 2. To provide useful knowledge to the public about the charity’s work that prompts an action or change in behaviour (e.g. a cancer prevention charity promoting benefits of regular testing)**
- 3. To be transparent and accountable for its practices, performance and operations (e.g. an annual report or financial statements)**

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– **Examples relating to the Part 2 of Test B that indicate fundraising include:**

- 1. Repeated requests or ongoing prolonged requests within a particular activity**
- 2. Emotive requests characterized by appeals to emotion vs. an explanation of charity’s work in a reasoned manner, or requests that focus on the hardship of the beneficiaries (e.g. telethons)**

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- **Where Test A (Substantially All Test) is met, all costs for the activity may be allocated as non-fundraising expenditures on the T3010 return**
- **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 and a portion as fundraising expenditures**

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• **Allocation of costs**

- **Allocation into categories - fundraising and/or charitable, political activity, management and administration, or other category**
- **Allocation based on the cost of the resources used for the content attributable to each objective for which the activity was undertaken**

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- “Resources” are not defined in the *Income Tax Act*
- CRA considers “resources” to include all financial assets plus all other assets which can be used to further the charity’s purposes
- e.g. staff, volunteers, directors, premises, equipment, supplies

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- 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
- 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

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EVALUATION GRID AS AN “INITIAL TOOL”

- An evaluation grid is used as an “initial tool” - based upon a ratio of fundraising costs to fundraising revenue on an annual basis (not based on the 80/20 disbursement quota)
- The ratio will place a charity in one of five categories
 - Rarely acceptable: More than 70% (charity nets less than 30%)
 - Generally not acceptable: 50% to 70% (charity nets 30% to 50%)

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- 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%)
- As the relative cost of fundraising expenditures rises, and the cost percentage increases, the more likely it is to be considered unacceptable

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OVERRIDING FACTORS AFFECTING THE GRID

- The 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
- Factors include
 - Conduct that decreases the risk of unacceptable fundraising
 - Conduct that increases the risk of unacceptable fundraising
 - Other circumstances

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- Conduct considered as decreasing the risk of unacceptable fundraising
 - Prudent planning processes
 - Appropriate procurement processes
 - Good staffing processes
 - Ongoing management and supervision of fundraising practice
 - Adequate evaluation processes
 - Use made of volunteer time and volunteered services or resources
 - Disclosure of fundraising costs, revenues and practice

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- Conduct considered as increasing the risk of unacceptable fundraising
 - 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 merchandize

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- 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

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- 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

- Each of the above conducts is explained in detail in the background document
- 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

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- **Other circumstances**

- 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
- The following are various circumstances that CRA may consider – and each is explained in detail in the background document
 - Small charities or charities with limited appeal

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- 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

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- Charities whose activities include lotteries or charitable gaming that is regulated provincially
- Charities engaging in cause-related marketing initiatives
- Charities with extraordinary spending, relative to their size, on infrastructure to ensure compliance with this fundraising policy

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CONCERNS ON DRAFT FUNDRAISING POLICY

- Very complicated policy and background document, may be difficult for registered charities to understand, let alone comply with
- Many of the requirements, determinative factors and criteria contained in the policy and background document are open to subjective interpretation—accordingly, there may be inconsistencies in the administration of the policy and audit of charities
- In order to ensure consistency of administration, clear guidance should be provided concerning how the overriding factors and circumstances are to be assessed and applied to the grid

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- The meaning of “fundraising revenue” used in the grid is not clear, e.g. Does it include grants?
- The ratio used in the grid is based on fundraising costs and revenue on an annual basis, but 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. – perhaps a rolling average approach may be more appropriate
- The ratio utilized by the grid appears to be arbitrary and without a clear underlying rationale – e.g. why a ratio of 35% to 50% is potentially not acceptable, but a ratio of 20% to 35% is generally acceptable

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- The ratio does not take into account the total operating cost or total revenue of the charity
- The ratio used in the grid is different from the disbursement quota under the ITA – the proposed policy should explain how the ratio in the grid relates to the calculation of disbursement quota
- This policy does not clearly explain that the grid is only an initial tool and it is not a determinative test and it is concerned that the grid would be used as the rule, without regard to the various overriding factors and circumstances

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- CRA is prepared to accept a higher ratio than that which is in the grid in relation to foundations, however this has not been clearly explained in the policy
- Since the grid will apply differently to foundations, perhaps the policy should set out a different grid for foundations
- It is questionable whether CRA has the constitutional jurisdiction to regulate certain aspects of a charity’s activities even if they relate to fundraising activities

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CONCLUSION

- Although more guidelines or regulations on fundraising activities by registered charities are welcomed initiatives, the charitable sector may be getting more than they realise
- The proposed policy and background document contain many questions and concerns that will need to be addressed when CRA develops the final version of the policy

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