

CRA CONSULTATION PAPER FOR A PROPOSED POLICY ON FUNDRAISING BY REGISTERED CHARITIES

*By Terrance S. Carter, B.A., LL.B., Trade-mark Agent
Assisted by Kimberley A. LeBlanc, B.A., LL.B., Student-at-Law*

A. INTRODUCTION

As a result of a growing demand from the media and the general public for more accountability from charities concerning the quantum of fundraising expenses, on March 31, 2008, Canada Revenue Agency (“CRA”) released a consultation paper regarding the preparation of a proposed policy on fundraising by registered charities (“Fundraising Policy”)¹. The stated objective of the Fundraising Policy is to replace the previous CRA policy statement “Applicants that are Established to Hold Periodic Fundraisers”² and to provide all registered charities with information pertinent to the use of resources for fundraising and the limits imposed by law. Specifically, the Fundraising Policy aims to assist charities by explaining how to distinguish between fundraising and other expenditures; clarifying how to classify and report activities intended to both raise funds and advance charitable programming; explaining when fundraising activities may preclude registration or result in revocation of registration; and explaining what factors are considered by CRA when assessing whether the fundraising undertaken puts a charity’s registration status at risk.

CRA is encouraging charities, government departments, the general public and individuals involved in the charitable community to submit any comments they might have in relation to the Fundraising Policy, and will consider all submissions received by June 30, 2008.

¹ Available online at: <http://www.cra-arc.gc.ca/tax/charities/consultations/fundraising-e.html>.

² CPS 001, available online at: <http://www.cra-arc.gc.ca/tax/charities/policy/cps/cps-001-e.html>.

This *Charity Law Bulletin* summarizes the content of the Fundraising Policy, as well as highlighting its significance for charitable organizations in Canada.

B. THE DIFFERENCE BETWEEN FUNDRAISING AND CHARITABLE PURPOSE OR ACTIVITIES

The Fundraising Policy explains that although all registered charities are required by law to have exclusively charitable purposes, as set out in their governing documents, the *Income Tax Act* (the “Act”) does not define the term “charitable”. The common law provides some assistance in determining the definition of charity in its legal sense and in applying that definition. Specifically, CRA indicates that the courts have determined that fundraising, whether undertaken as a charitable purpose or as an activity of the charity, is not in-and-of-itself charitable. Additionally, fundraising activities are not normally treated as advancing a charity’s charitable purpose. In this regard, charities are generally unable to report the costs of fundraising as charitable expenditures on their annual T3010A information return.

The Fundraising Policy clarifies that although the common law requires that charities have exclusively charitable purposes and the Act requires that charities devote all of their resources to charitable purposes and activities, they are able to apportion a modest amount of resources for fundraising. Additionally, every action that a charity undertakes does not have to be in-and-of-itself charitable. The common law provides charities with the authority to carry out fundraising activities in support of their charitable purposes even though alone, fundraising is not necessarily charitable.

C. PROHIBITED CONDUCT

As CRA has previously published guidance pertaining to specific prohibited fundraising activities³, an in-depth discussion of this issue is not undertaken within the Fundraising Policy. However, some additional direction is made available with respect to conduct that fails to meet statutory and/or common law requirements and thereby may lead to ineligibility for status as a registered charity.

³ See CPS-019, “What is a Related Business?” available online at <http://www.cra-arc.gc.ca/tax/charities/policy/cps/cps-019-e.html>; CPC-002, “Policy Commentary” available online at <http://www.cra-arc.gc.ca/tax/charities/policy/cpc/cpc-002-e.html>; Registered Charities Newsletters No. 12, “Spring 2002” available online at <http://www.cra-arc.gc.ca/E/pub/tg/charitiesnews-12/news12-e.html>; Registered Charities Newsletters No. 20, “Fall 2004” available online at <http://www.cra-arc.gc.ca/E/pub/tg/charitiesnews-20/news20-e.html>; and Terrance S. Carter & Suzanne E. White, “New CRA Policy On Charities And Business Activities” in *Charity Law Bulletin* No. 37 (February 19, 2004) online: <http://www.charitylawbulletin.ca>.

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

- a) Conduct that is illegal or contrary to public policy;
- b) Conduct that results in excessive or disproportionate private gain by individuals or corporations;
- c) Conduct that has become a main, prevailing, or independent purpose of the charity; and
- d) A charity not devoting 100% of resources to charitable ends since the harm arising from the charity's fundraising practice outweighs its public benefit.⁴

CRA has indicated that detailed explanations of each of these areas of prohibited conduct will be published by late April or early May 2008.

D. ALLOCATION OF FUNDRAISING EXPENSES VS. CHARITABLE EXPENSES

The Fundraising Policy indicates that in general, on their T3010A return, charities are to report 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 as fundraising expenditures unless it can be demonstrated that the activity would have been undertaken without the said solicitation of support. CRA further clarifies that "a solicitation of support includes any request by the charity, or someone acting on its behalf, for financial or in-kind donations and also includes the marketing and sale of goods or services not within the entity's charitable programs"⁵ (i.e. selling chocolate bars to fundraise) even where no donation receipt is issued for the transaction. Petitions for government funding and requests for support from other registered charities do not fall within CRA's description of solicitations for support.

The Fundraising Policy sets out the test which a charity must meet in order to demonstrate that an activity would have been undertaken without the solicitation of support. Specifically, charities must demonstrate either A or B below:

- a) Substantially all of the resources devoted to the activity advance an objective other than fundraising;
or
- b) All of the following apply to the activity:
 - i) 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.

⁴ *Supra* note 1.

⁵ *Ibid.*

- ii) The activity does not include ongoing or repeated requests, emotive requests, gift incentives, donor premiums, or other fundraising merchandise.
- iii) The audience was selected for reasons other than their ability to give.
- iv) Commission-based remuneration or compensation derived from the number or amount of donations is not being used.⁶

CRA indicates that where the test in A is met, all costs for the activity may be allocated as non-fundraising expenditures on the T3010A return. Where the tests in B are met, a portion of the costs for the activity may be allocated on the T3010A return as non-fundraising expenditures and a portion as fundraising expenditures.

CRA further indicates that where an activity demonstrably furthers one of the charities purposes, there are certain circumstances wherein charities may be permitted to allocate a portion of the costs of an activity other than to fundraising expenditures even though the activity would not have been undertaken without the solicitation of support. In order to show that an event or activity advances a charity's charitable programming, the activity must have the effect of prompting an action or changing a behaviour other than giving a donation or other financial support. Additionally, the event or activity should reach a significant portion of the charity's stakeholders, other than donors, or exhibit greater emphasis on helping beneficiaries other than to obtain financial support. Where an activity raises awareness of a charity's mandate or work in conjunction with fundraising through a non-charitable third party, such as for-profit telemarketing, direct mail or canvassing companies, CRA generally does not consider the above requirements to be met, and therefore, charities may not allocate costs for such activities other than as fundraising expenditures.

E. EVALUATION OF FUNDRAISING ACTIVITIES AND EVALUATION GRID

The Fundraising Policy indicates that in assessing the acceptability of a charity's fundraising, CRA initially uses an evaluation grid which, using the ratio of fundraising costs to fundraising revenue during a fiscal period, classifies a charity's fundraising into one of five categories ranging from acceptable to rarely acceptable. Based upon the ratio of fundraising costs to fundraising revenue, the proposed evaluation grid is as follows:

- ◆ Rarely acceptable: More than 70% (charity nets less than 30%)
- ◆ Generally not acceptable: 50% to 70% (charity nets 30% to 50%)
- ◆ Potentially not acceptable: 35.1% to 49.9% (charity nets 50.1% to 64.9%)
- ◆ Generally acceptable: 20% to 35% (charity nets 65% to 80%)
- ◆ Acceptable: less than 20% (charity nets more than 80%)

⁶ *Ibid.*

It is important to point out that the grid is based upon a ratio of fundraising costs in comparison to fundraising revenue, which is different from the disbursement quota under the Act, that allow a maximum only 20% of the previous year's received income to be expended on fundraising and administrative costs.

F. CONDUCT CONSIDERED INCREASING OR DECREASING THE RISK OF UNACCEPTABLE FUNDRAISING

The Fundraising Policy explains that prior to determining that a charity's fundraising is not acceptable, CRA will review a charity's fundraising conduct. CRA considers some types conduct to decrease the risk of unacceptable fundraising, while other types of conduct may increase this risk.

CRA will look to the presence of sound practices, the absence of practices that increase the risk or unacceptable fundraising, as well as the recent trend in the charity's ratio of costs prior to making a determination as to the acceptability of a charity's fundraising. Conduct which CRA considers to decrease the risk of unacceptable fundraising by a charity include:

- ◆ prudent planning processes;
- ◆ Appropriate procurement processes;
- ◆ Good staffing processes;
- ◆ Ongoing management and supervision of fundraising practices;
- ◆ Adequate evaluation processes;
- ◆ Use made of volunteer time and volunteered services or resources; and
- ◆ Disclosure of fundraising costs, revenues and practice.⁷

Conversely, the following conduct, when present, is viewed by CRA 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;
- ◆ 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;

⁷ *Ibid.*

- ♦ misrepresentations in fundraising solicitations or disclosures about fundraising or financial performance; and
- ♦ combined fundraising and charitable program activity, where contracted to a party that is not a registered charity or that is compensated based on fundraising performance.⁸

Additionally, the Fundraising Policy lists several further circumstances that the CRA may consider in making a determination as to the acceptability of a charity's fundraising. Although not expressly stated, it is presumed the following additional factors will be considered to mitigate the risk of unacceptable fundraising:

- ♦ small charities or charities with limited appeal
- ♦ charities that are investing resources in donor acquisition or other types of fundraising in which the return will not be realized in the same year in which the investment is made
- ♦ charities whose main or major purpose is to make gifts to qualified donees, or to one or more registered charities and as a result have a different cost structure than charities that carry on their own activities
- ♦ charities whose activities include lotteries or charitable gaming that is regulated provincially
- ♦ charities engaging in cause-related marketing initiatives
- ♦ charities with extraordinary spending, relative to their size, on infrastructure to ensure compliance with this fundraising policy.⁹

CRA intends to provide detailed explanations of the conduct that both increases and decreases the risk of unacceptable fundraising, as well as the additional circumstances that CRA considers as listed above by late April or early May 2008.

⁸ *Ibid.*

⁹ *Ibid.*