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CRA Releases New Fundraising Guidance for Charities

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On April 20, 2012 the CRA released its much anticipated "Fundraising by Registered Charities Guidance", CG-013 (the "Guidance"). The new guidance is a significant improvement over its predecessor, which had been released June 11, 2009. It is better organized and more detailed. Although charities will no doubt wish to review the Guidance carefully themselves, this bulletin highlights the Guidance's main points.

1. What is fundraising?

The *Guidance* defines fundraising as "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."

Several examples of fundraising are provided in the Guidance, including:

- Donor stewardship, which occurs when a charity invests resources in relationships with past donors in the hopes of encouraging future gifts. This is considered fundraising because it involves an implied request for future gifts.
- Donor recognition activities, which are considered fundraising for the same reason. Thank you gifts to donors and other forms of acknowledgment must be reported as fundraising expenses if they exceed a nominal amount. A per-donor cost of \$75 or 10% of the value of the donation, whichever is less, is considered nominal.
- Membership fees, where donating is a condition of membership or where donation incentives and premiums are widely used to promote joining as a member, the membership program will be fundraising.
- Cause-related or social marketing ventures, provided that most of the expenses are covered by a non-charitable partner and the charity's contribution is the use of its logo or other intellectual property.
- Activities that are related to fundraising efforts, including planning or researching fundraising activities, recruiting volunteers for fundraising efforts and hiring third-parties.

Recruiting volunteers to assist with the general operations of the charity or a related business is not fundraising. For the purposes of the Guidance, fundraising also excludes activities aimed at securing funding from other charities and government organizations.

2. Responsibility for Compliance with the Guidance

Charities are responsible for ensuring that their fundraising activities comply with the Guidance, whether the fundraising is carried out by the charity or by someone acting on the charity's behalf. The Guidance suggests that fundraising on a charity's behalf will generally occur pursuant to the terms of a fundraising agreement. Local organizations and individuals that hold fundraising events on their own initiative and later donate the proceeds to the charity are not considered to be fundraising on the charity's behalf, unless they have entered into a fundraising agreement with the charity. Absent a fundraising agreement, the charity will generally not be responsible for ensuring that fundraising activities carried on by these organizations or individuals comply with the Guidance.

3. Unacceptable Fundraising

Charities engaging in unacceptable fundraising practices risk a range of sanctions, up to and including revocation of charitable status. Fundraising is unacceptable if it:

- Becomes a non-collateral, non-charitable purpose of the charity or an unrelated business;
- Delivers more than an incidental private benefit; or
- Is illegal, contrary to public policy or deceptive.

3.1 Non-Collateral Purpose or Unrelated Business

Charities cannot have fundraising as a collateral purpose, since fundraising is not in itself a charitable purpose or charitable activity in furtherance of a charitable purpose. The CRA has indicated that fundraising may be a collateral purpose of a charity where it becomes a "focus" of the organization.

The CRA draws a distinction between operating for the purpose of funding other charities and government organizations and operating for the collateral non-charitable purpose of fundraising. Subject to certain conditions, a foundation or charity may have as a focus, even as its primary focus, fundraising for other charities and government organizations. For this to be the case, the proceeds raised must exceed the cost of the fundraising and no more should be spent on fundraising than required. All other conditions for acceptable fundraising must also be met.

Fundraising that amounts to carrying on a business is unacceptable unless it qualifies as a related business of the charity. A charity is generally considered to be carrying on a business where it engages regularly in a commercial activity with the intention of earning a profit. In order to qualify as a related business, the activity must be operated substantially by volunteers (90%) and be linked and subordinate to the charity's purpose.

3.2 Non-Incidental Private Benefit

Fundraising will be unacceptable if it delivers more than an incidental private benefit. A private benefit will be incidental if it is necessary, reasonable and proportionate to the public benefit achieved.

Where the benefit is conferred upon a party that stands in a non-arms-length relationship to a director or trustee of a charity, more stringent requirements apply. The CRA has indicated that such arrangements will nearly always be viewed as providing more than an incidental private benefit. For this kind of benefit to be acceptable, it must be clearly justified. For instance, it might be acceptable for a charity to hire a company owned by a director to carry out fundraising work if the company won the contract as part of a public tender process. Even where the benefit can be justified, charities should be mindful of other legal obligations, like the duty to avoid conflicts of interest, which may impact the proposed arrangement.

3.3 Illegal, Contrary to Public Policy, or Deceptive

Illegal fundraising includes activities that are criminally fraudulent, that facilitate terrorism or that violate statutes governing charitable fundraising, gaming, or consumer protection. Fundraising connected to improper receipting practices also falls under this category. Where fundraising is associated with illegal conduct, such as where the charity knows or ought to know that the fundraising will further illegal activities, the fundraising will also be unacceptable. This may be the case where a charity is involved with an abusive tax shelter.

Fundraising will be contrary to public policy if it fails to respect the policies of a government or regulatory body (e.g. the Canadian Radio-television and Telecommunications Commission telemarketing rules). Fundraising will also be contrary to public policy if it results in harm to the public interest.

The public is harmed when charities adopt deceptive fundraising practices, such as misrepresenting how donations will be used. Contracts where third-party fundraisers have received 70% or more of the proceeds, without this fact being brought to the attention of the public, have been found by the courts to be contrary to public policy. Charities should also be careful of making claims that 100% of the proceeds will go towards a charitable cause. Most often, there are at least some fundraising expenses that the charity must cover.

4. Allocation of Expenditures and the Fundraising Ratio

Calculating the Fundraising Ratio

A charity's fundraising ratio is a useful self-assessment tool and can be used to determine when the CRA is likely to seek further justification for fundraising expenditures.

The fundraising ratio is calculated over a fiscal period according to the following:

- Revenue from lines 4500 (receipted donations) and 4630 (other fundraising revenue) of the charity's Form T3010 are added together.
- The charity's fundraising expenses (line 5020) are divided by the resulting sum.

The value of all receipted donations must be included, and not merely the value of those donations that resulted from fundraising efforts. Donations from other charities and government organizations will not be included, since this income is recorded on line 4310.

Evaluating a Charity's Fundraising Ratio

If the fundraising ratio is under 35%, the CRA is unlikely to question the fundraising costs. If the ratio is over 35%, the CRA will look at the charity's fundraising ratio over the years to see whether the charity has a history of high fundraising costs. The higher the ratio is, the more

likely the CRA is to question the costs. If the fundraising ratio is over 70%, the CRA will seek further justification. The charity should be prepared to show that it is not engaged in unacceptable fundraising.

Allocating Expenditures

Activities may have charitable, management/administrative, fundraising or political activities components. Where "substantially all" of an activity was devoted to fundraising (i.e.: 90% or more), all expenditures should be allocated to fundraising. Where "substantially all" of the activity would have been undertaken without the fundraising component (i.e.: 90% or more of the activity), the charity may allocate all costs to other components. For cases falling between these extremes, the charity should pro-rate the costs of the activity between fundraising and other components, as appropriate. The onus is on the charity to justify its allocations.

In determining how to allocate costs, the charity must consider the importance of the fundraising to the activity; the proportion of charitable, management/administrative, fundraising or political activities components; and the resources devoted to each component. The Guidance provides useful examples of how the above considerations should be applied. For instance, considering the proportion of various components might be useful where the activity is a publication. If 20% of the publication is devoted to soliciting funds for the charity and 80% is devoted to educating the public on taking action to advance a charitable cause, then 20% of the costs should be allocated as fundraising expenditures and 80% as charitable expenditures.

The CRA considers all costs associated with the following activities to be fundraising expenditures:

- Activities that involve targeting an audience or selecting participants based on their ability to give;
- Activities where participants are encouraged to raise pledges;
- Gaming activities;
- Activities that are focused on raising awareness about the charity or the its cause (unless such information qualifies as charitable content, as discussed in the section below);
- Infomercials and telemarketing;
- Branding and promoting the charity through cause-related or social marketing; and
- Golf tournaments and gala dinners.

Charitable Content

Identifying what qualifies as charitable content can be challenging. Raising awareness about a charity, its programs, or even an issue or cause is not generally considered a charitable activity. Providing information to the public will only be a charitable activity where it informs the public on how to take specific actions to advance a charitable cause other than the advancement of education.^[1] The information must be distributed in such a way that it is likely to reach the target audience. The information must be actively disseminated and cannot merely be made available to the public.

Charitable content will generally have been created by the charity. Where a charity has reproduced publicly available information it did not originally create, the charity must be able to explain why the recirculation of such material should be considered the charity's own activity.

Fundraising Content

Fundraising content relates to the solicitation of donations or gifts from non-qualified donees or the sale of goods or services to raise funds for the charity. Securing funds from other charities or government organizations generally relates to management and administrative content. Fundraising content may include:

- Information about the charity's programs or services to encourage donations;
- The provision of goods and services to anyone other than the charity's beneficiaries or which does not directly further the charity's charitable purpose;
- The management and administration of fundraising activities; and
- Information about gift incentives, premiums or other fundraising merchandise.

Managerial/Administrative Content

As mentioned above, securing funds from other charities and government organizations generally relates to management and administrative content. Management and administrative content also includes:

- Arranging, holding and reporting on meetings of boards of directors;

- Booking, auditing, accounting and other administrative services; and
- Purchasing supplies and/or equipment and paying rent.

It is unusual for a fundraising event to have a management or administrative component because the CRA considers the planning, management and administration of fundraising activities to be fundraising.

Political Activities Content

Political activities content relates to any activity which attempts, directly or indirectly, to sway public opinion on social issues or otherwise influence the development of a law or policy in Canada or abroad.

5. Best Practices

5.1 Planning

Before undertaking fundraising, the charity should, at a minimum, consider:

- Its fundraising goals, including the use to which proceeds will be put;
- All relevant regulatory obligations;
- The resources devoted to charitable activities and projected fundraising costs for the year;
- The costs and anticipated proceeds of the proposed fundraising activity; and
- Other possible fundraising methods.

It is important that the charity have an identified use or need for the proceeds prior to commencing fundraising. Fundraising without an identified use or need may be an indicator that fundraising has become a collateral purpose of the charity or that a non-incidental private benefit is being conferred.

Creating a reserve fund policy can help to diminish the likelihood that a charity will find itself fundraising without an identified use or need. The appropriate size of the fund will vary depending upon the situation of the particular charity.^[2]

5.2 Procurement and Staffing

General

The *Guidance* contains helpful suggestions on best practices for procuring goods, hiring third parties and managing and supervising ongoing fundraising. The effort and cost that should be devoted to meeting these practices will vary depending upon the nature and scope of the fundraising undertaken by the charity.

Before procuring goods from a supplier or hiring in-house staff or a third party contractor, a charity should conduct research to ensure that it is getting the best value for its money. When entering into a contract with a third party, a charity should protect its interests by carefully reviewing the contract, limiting the contract's duration and including a provision allowing the charity to terminate the contract if the third party does not act in accordance with the Guidance.

Hiring In-House Staff

Care should be taken in determining the remuneration of staff hired to conduct fundraising activities. The compensation should be based on a salary survey and should be reasonable compared to the compensation received by other employees at the charity, given their roles and responsibilities. The charity must ensure that the staff's compensation does not exceed the fair market value of the services provided.

Charities should avoid tying employee compensation to fundraising success (e.g. by providing bonuses dependent on raising certain amounts). These kinds of payment structures may indicate that the charity is conferring a non-incidental private benefit and/or acting in a manner that is harmful to the public interest.

Contracting Third Parties

Services should only be contracted out to third parties if they cannot be delivered as effectively using the charity's resources. Again, where compensation is based on performance, the CRA is more likely to find that a non-incidental private benefit is being conferred. If the charity chooses to hire a contracted fundraiser, it should be able to show that the expenditure is an investment that will result in lower costs for subsequent activities.

When hiring third parties, most of the revenue should go to charitable purposes and not contracted third parties. Fundraising where a high percentage of the fundraising revenues goes to third parties may cause harm to the public interest. In such cases, the charity must be able to show why the private benefit is acceptable.

5.3 Ongoing Management and Supervision of Fundraising

Charities should ensure that oversight measures are in place to monitor fundraising on a regular basis. These measures should include:

- Establishing fundraising policies that set out acceptable and unacceptable behaviour;
- Pre-approving fundraising solicitation scripts and other representations;
- Following up with donors;
- Monitoring the receipting process;
- Using internal audits to review revenue and expenditures; and
- Exercising contractual rights to review or audit the records of work done by any third party.

Charities should also periodically calculate the ratio of fundraising costs to total resources devoted to charitable activities. Fundraising where the associated costs exceed the resources devoted to charitable activities is a red flag for inappropriate fundraising. The CRA considers this to be "strong indicator" that the charity has a collateral non-charitable purpose or is conferring a non-incident private benefit. Showing that fundraising costs are reasonable given market rates will not be enough to justify the imbalance.

In calculating the resources devoted to charitable activities and to fundraising, charities should be careful to include any use of non-financial resources, like volunteer time. Volunteer time devoted to fundraising activities will be considered a fundraising cost, while volunteer time devoted to running charitable programs will be considered a resource devoted to charitable activity. Any use of non-financial resources should be reasonable, efficient and carefully documented.

Finally, charities should regularly evaluate their fundraising activities to ensure that they are in line with the Guidance and to evaluate their fundraising success and cost-effectiveness.

5.4 Disclosure

The CRA recommends that charities disclose all fundraising costs, revenues, arrangements, and practices, including hiring and procurement processes. Disclosure must be accurate, timely and accessible. Generally, information should be made available to the general public, unless the fundraising efforts have been confined to a clearly defined group. Where further information may be forthcoming, the charity should indicate that the information is not final and should try to update the information as soon as possible.

Disclosure obligations are less onerous for cause-related or social marketing ventures where more than 90% of the costs of the initiative are borne by a non-charitable partner and all the costs and revenues of the charity are adequately disclosed.

The rationale behind the *Guidance's* disclosure recommendations is to protect the public from misrepresentations and deceptive fundraising. Charities should be mindful of the many ways in which a misrepresentation can occur. A misrepresentation may arise out of a failure to disclose relevant information and need not be fraudulent, illegal or even intended.

Charities should also be mindful that they may be responsible for misrepresentations made by a third party acting on the charity's behalf. It is prudent for a charity to include a clause in any contract with a third party prohibiting the third party from making misrepresentations on the charity's behalf.

5.5 Record Keeping

It is important for charities to keep detailed records of their fundraising activities. The onus is on the charity to show that it has complied with the *Guidance* and the requirements of the *Income Tax Act*. At a minimum, charities should keep records of the following:

- Minutes of meetings where fundraising decisions were made;
- Records of research conducted in preparation for fundraising, particularly research conducted to determine appropriate costs;
- Use of any non-financial resources, such as volunteer time;
- Documentation on any procurement processes, including documentation on the negotiation and approval of the contracts; and
- Written copies of all fundraising agreements entered into with third parties.

Failure to keep adequate records is a possible indicator that the charity is conferring a non-incident private benefit and/or engaging in fundraising that is deceptive or contrary to public policy.

6. Factors That May Influence the CRA's Evaluation

The CRA recognizes that fundraising effectiveness may vary across charities for legitimate reasons. The Guidance provides four examples of case-specific factors the CRA is prepared to consider when evaluating a charity's fundraising. These factors are discussed below.

Small Charity

Small charities may have difficulties raising funds as efficiently as larger charities. Charities are considered small if they have revenues of under \$100,000. In evaluating the fundraising costs of smaller charities, the CRA will consider the profile of the community the charity serves and whether the charity has adequately controlled costs.

Causes with Limited Appeal

Charities advancing causes with limited appeal may have more difficulty raising funds from the public. Increased fundraising costs may be acceptable in such cases, provided that the charity can show that:

- Its cause has limited appeal;
- The higher than average fundraising costs are the direct result of the nature of the cause;
- It considered other fundraising methods and chose the most efficient and effective one; and
- The costs are adequately controlled.

Donor Development Programs

Donor development programs are activities a charity undertakes to develop relationship with donors or potential donors in order to encourage donations down the road. It includes donor stewardship activities, telemarketing campaigns and special events held as a means of recognizing potential donors. Higher fundraising costs associated with donor development programs are acceptable provided that the charity can show that it has paid fair market value or less for any fundraising merchandise or services. The charity must also be able to show that costs were adequately controlled.

Gaming Activities

The CRA will accept higher fundraising costs associated with gaming activities so long as they are carried out in compliance with provincial or territorial regulations. The Guidance notes that applicable legislation commonly considers a revenue ratio of 70% or higher to be acceptable for gaming activities.

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[1] Activities that advance education are subject to particular requirements. See, for instance, *News to You Canada v. Minister of National Revenue*, 2011 FCA 192.

[2] A list of factors a charity should consider in determining the amount of its reserve fund can be found in the Guidance.

This publication is intended to provide information to clients on recent developments in provincial, national and international law. Articles in this newsletter are not legal opinions and readers should not act on the basis of these articles without first consulting a lawyer who will provide analysis and advice on a specific matter.

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