ONTARIO NONPROFIT NETWORK

Briefing Note to the Field:

Revenue Canada's Proposed Guidelines for Fundraising Expenses

Briefing Overview

If you are a small or mid-size charity, one of the 99% of charities in Ontario with revenues of under 10 million dollars[1], the proposed fundraising guidelines have the potential to seriously impact your organization. They will:

- impact your ability to raise funds from the general public;
- impose a significant additional administrative burden and associated costs;
- potentially impact your ability to earn income and;
- may result in you losing your charitable registration for high fundraising costs over which you may have little control or choice.

These guidelines have an extraordinarily large reach and there are some serious concerns about the impact of this policy on the small and medium sized charities. CRA's 'one size fits all' approach in the guidelines will most impact the small and medium charities who typically have no fundraising department or at best have one or two people dedicated to raising funds from the public and organizing fundraising events. However, there are also provisions in these guidelines that are important for the protection of the integrity of fundraising and charitable activity in Canada that have little connection to fundraising expenses. It is our recommendation that these guidelines be broken down into separate guidelines.

In the final week of June, Revenue Canada posted the background material that supports their policy document on fundraising guidelines (http://www.cra-arc.gc.ca/tx/chrts/cnslttns/fndrsng-eng.html). The timing of the consultation period during the summer season means that charities will have trouble involving their Boards of Directors, as most Boards do not meet in July and August. However, these fundraising guidelines are sufficiently important that ONN is recommending that charities have summer Board decision-makers approve a submission from your charity in time for the August 31 deadline. We encourage you to write to CRA expressing your views on the guidelines.

[1] Nonprofit and Voluntary Sector in Ontario, National Survey of Nonprofit and Voluntary Organizations, www.imaginecanada.ca

Introduction

In this brief we have attempted to provide you with our analysis of the intent and impact of the guidelines. Analysis has been difficult as the intent of the guidelines is not stated and we have struggled to decipher the underlying objectives. Is CRA responding to the media's concern over the use of third party fundraisers? Are they focused on the fraudulent tax shelter schemes they have recently uncovered? Or, are they trying to rein in big philanthropy which is increasingly successful in raising large donations but needs to make large expenditures to land them?

Since we do not know the ultimate purpose or intent we cannot suggest alternate ways CRA might achieve its objectives. This brief, therefore, is not as constructive as we would have liked. Hopefully there will be opportunity for small and mid-size organizations to work with CRA in the future to design guidelines that meet CRA's objectives while supporting the charitable work of the vast majority of charities.

A CORE ISSUE:

Fundraising to support charitable objects is a charitable activity

The underlying premise of these guidelines holds that fundraising is not a charitable activity. While there may be a question at law about this, for the small and medium charity charitable fundraising, in practice, is an integral component of their charitable activities. Raising funds to undertake charitable activities is as old as charity itself -alms for the poor being one of the first charitable undertakings. No charitable objects can be achieved without having the resources to undertake them.

Tracking fundraising revenue and expenses is important regardless of how fundraising is classified but the approach to the monitoring of fundraising expenses could be greatly simplified for small and medium charities if fundraising was recognized as a charitable activity. For these charities fundraising is an integrated part of their every day activities.

Today we indeed have a strange situation for charities. CRA takes the position that a charity's costs to secure, manage and account for revenues from government, foundations and other charities is not a fundraising expenses Yet costs to secure, manage and account for donations from the public is a fundraising expense and, moreover, is not a charitable activity. Provincial lotteries and other gaming activities, even though they return only a small portion of their costs to the charity, are also exempt from CRA expense/revenue review. On the other hand, many earned income efforts undertaken by charities are classified, under these guidelines, as fundraising expenses even though the different cost structure associated with many earned income initiatives will distort and inflate fundraising expenses.

The playing field is distinctly unlevel. The proposed fundraising expense guidelines show little understanding of the realities of fundraising for the small and mid-sized charity and, if enforced the way they are currently drafted, will result in the revocation of many of their charitable charters, as they will be unable to meet the CRA guidelines for acceptable fundraising revenue/expense ratios.

THE GUIDELINES IN CONTEXT:

Understanding Recent Social Policy Trends and Their Impact on Fundraising Activity in Canada

The intent and impact of these fundraising guidelines must be understood in context. Social funding trends in Canada since the early 1990s have seen stagnant or shrinking levels of government funding[2]; moreover, the capacity of Canadian foundations and united appeals to pick up the shortfall is not there as Canada has a relatively small foundation sector. The result has been a significant increase in charities seeking individual donations and/or engaging in earned income ventures to obtain the funds to undertake their missions.

The past fifteen years has seen what amounts to a revolution in how charities and the not-for-profit sector operate and our regulations and legislation have not yet adapted to this new reality. We urgently need updated legislation and regulations for our organizations providing public benefit to better support their work. Unfortunately guidelines that seek to turn back the clock to a simpler time, such as these, are not only going to be largely ineffective but they hurt most those with the least capacity – the small and mid-size organization. [3]

As the ability and willingness of governments to fund services for its citizens has diminished, large, key service sectors such as hospitals, colleges and universities, traditionally almost exclusively government funded, are significantly expanding their efforts to secure charitable donations. These sectors dwarf other charitable sectors with their size and capacity (1% of nonprofits account for 38% of revenues)[4] and have significantly increased the competition for the philanthropic donor as they bring big budgets, professional staff and key social connections to the fundraising arena. This occurred at the same time as arts and community service organizations,

[2] Clutterbuck, P. Howarth, Rob. Heads up Ontario! Current conditions and promising reforms to strengthen Ontario's nonprofit community sector, Toronto Social Planning Council 2008

[3] For this paper we define charities by total revenues - small charities as under $1million while mid-size charities are $1-10 million. Of the small charities 35 % are tiny (under $100,000). An alternative method would be to classify charities by the size of their receipted charitable revenues for purposes of fundraising expense guidelines. e.g. Tiny (<$100,000 in receipted donations), small ($100,000-$500,00 receipted donations,) Medium ($500,000- 1million receipted donations,) and large (over $1million receipted donations).

[4] Hospitals, Colleges and Universities account for 1% of nonprofit organization but 38% of all revenues, Nonprofit and Voluntary sector in Ontario, www.imaginecanada.ca

also reeling from funding cuts, were increasing their efforts to fundraise. The result has been predictable - big philanthropy has captured an increasing share of the charitable dollar and the small and medium arts and community organizations are falling further and further behind.

The increased competition for the charitable dollar has also been accompanied by the rise of what some call 'corporate philanthropy'. Private individuals have been encouraged to view their donation as an investment. The 'donor as investor' has required charities to increase their level of donor involvement and contact. Many private donors now require as much attention as government contracts.

Given these trends, it seems almost punitive for CRA to put the onus on charities to keep their fundraising costs in line. It may not be possible to put the genie back in the bottle and over regulating charities will certainly not help the situation. Very different strategies are required to address these issues and trends.

KEY ISSUES FOR SMALL AND MID-SIZE CHARITIES

1. ***The guidelines are at odds with how fundraising is undertaken in the field,*** where fundraising is often an integrated part of the fabric of a charity and its local community. The CRA fundraising expense guidelines hold that any and all involvement with donors or potential donors is preparation for, or part of, a solicitation and must be expensed as a fundraising expense. Interaction with a donor or potential donor both before and after a donation is not viewed by CRA as charitable activity. The guidelines require the charity to deconstruct their activities and isolate donor interaction from their community activity.

For many arts organizations and community-based charities where donors are audience members, family members of program participants, program participants themselves, neighbours and volunteers, making these distinctions between donor and other stakeholders is not easy nor, in many instances, even feasible. Building an involved, knowledgeable and expanding community is important both for fundraising but also for program. In smaller organizations volunteers and senior staff will spend their unnecessary time documenting their days, trying to sort out the motivation behind every interaction with stakeholders. Typically, these organizations have booked development staff, if they had, any against fundraising and recorded direct out of pocket expenses such as mailing and printing costs, recognition awards etc. It was a simple documentation that calculated direct fundraising expenses only and freed them to get on with their work.

Once you move beyond the small and medium size organizations, philanthropy changes. It is big business with big stakes. Regulating the fundraising market is a complex challenge that requires new thinking and new approaches. Regulations for multi-million dollar organizations with large fundraising departments may need to be different than regulations for small and medium organizations. Applying big philanthropy standards to organizations with one, or no, development staff is unduly onerous and will certainly ensure they can never develop the capacity to compete with the bigger players.

2. ***Charities that operate exclusively, or almost exclusively, on donations from the public will have great difficulty making the charitable activity disbursement quota of 80% of revenues.*** CRA's own recent report on small and rural charities[5] describes the difficulties small organizations have in meeting their disbursement quota with the increasing cost of audit and compliance requirements.
CRA's expanded definition of fundraising costs, costs that would have formally been viewed as community outreach, organizational communications and education, will definitely put these tiny charities off-side on their disbursements. The CRA disbursement quota is disproportionately hard on organizations that rely heavily on fundraising from the public.

Interestingly, in the CRA document on small and rural charities CRA reported that the charitable sector received 163.1 billion dollars in 2006 and of this of these 111.8 billion was charitable programming. This means overall 51.2 billion or 32% of sector revenues were spent on administration, fundraising and other non-program activities, well above the 20% allowed for charitable funding raised from individuals. If fundraising costs remain outside of charitable programming the disbursement quota must be adjusted to a more reasonable level.

3. ***The guidelines mistakenly include most earned income from sales and fees as fundraising.*** In the past youth selling chocolate bars was considered a fundraising expense because charities did not really have a category for earned incomes and it was typically a very minor activity. However, after the cuts in government funding in the 1990's agencies set out to diversify their sources of income to make their organizations and their clients less vulnerable. Their efforts included increased efforts to raise charitable donations and a new look at revenue generation. By 2003, earned income was significant. We do not have the breakout for charities but 43% of revenue in the nonprofit sector in Ontario (excluding hospitals and universities) is earned income. [6]

Recreation programs charge program fees. Arts organizations of all kinds have focused on ticket sales and increased related merchandising. Social service organizations have looked for both sales and service fees from their work and environmental groups are offering green services and consulting.

The CRA fundraising guidelines do not restrict themselves to revenues for which the

[5] Small and Rural Charities: Making a Difference for Canadians, CRA, Canada, 2008
[6] Nonprofit and Voluntary Sector in Ontario, www.imaginecanada.ca

donor receives a tax receipt and is widely understood to be philanthropy. They include revenues that are earned income from sales and fees - revenues that should be accounted for and reported separately.

The youth volunteers who sell chocolate bars to fund their program are seen as fundraising and the expenses must be shown as fundraising. Meanwhile community thrift shops are grandfathered as related businesses for their charities but church bazaars, the original thrift exchange, are viewed as fundraising.

The guidelines explain the difference between program and fundraising by giving the example of a charity for disable adults that mounts and sells tickets for a performance in which its beneficiaries participate. The charity produces materials to promote the event in the community and the costs associated with that promotion are to be treated as fundraising, while the production costs are to be treated as charitable because CRA considers the production as part of a therapeutic program.

Unfortunately, in the field the line between fundraising and charitable activity is not a clear one. What does this example mean for performing arts organizations? Does it this mean all marketing costs for ticket sales are fundraising expenses? If not, then why is the disabled adults' performance different? What of the efforts of arts organizations to earn income from the sale of merchandise related to the performances? Are the costs associated with these sales to be fundraising expenses like the youth's chocolate bars?

Such a broad definition of fundraising expenses will significantly inflate the cost of fundraising and risks misleading the public regarding the true cost to obtain their charitable donation.

It is not only the arts organizations that will be in difficulty. What do these examples mean for the homeless women's pottery collective? They rely on a combination of sales and charitable donations to keep their program in operation. Would costs associated with announcing and mounting their sales be categorized as fundraising expenses, like the program serving people with disabilities, or would they be like the youth with all their input costs included as fundraising expense for any sales? How will charities sort all this out? A more fundamental question, however, is why would any of these income generating expenses be considered fundraising expenses when they have nothing to do with obtaining a receipted charitable donation from the public?

The trend to increased self-reliance for charities and the programs they offer requires that earned income be differentiated from fundraising revenues. Fundraising expenses should not include the costs associated with revenue from earned income.

4. ***Tracking and calculating fundraising expenses according to these guidelines will add an extremely onerous administrative burden***. The administrative burden to track, categorize and document fundraising expenses will be more complicated and complex than that currently required by government and foundation grants. Moreover, existing recording and accounting systems will require modification if they are to work at all.

For the majority of charities without large fundraising departments providing the documentation on their activities will be very onerous as the line between fundraising activities and charitable program is often very fuzzy. Furthermore, charity staff multi-task with such frequency that they will have to complete regular time sheets to provide a paper trail should they be audited by CRA. For most government and foundation programs, staff is budgeted against the different grants but detailed time records are not kept unless billing is done on a fee for service basis. Agency staff simply get the job done. Job descriptions in small and medium agencies are often atypical and extend well beyond what is written on paper. Agencies can track and categorize expenditures for fundraising activities but costing non-dedicated staff resources and breaking out donor contact from other agency activity will be quite another matter.

Consideration should be given to a simplified short-form reporting for the small and medium charity, similar to that provided for small business and their GST reporting.

5. ***The guidelines include a grid of fundraising expense/revenue ratios that CRA finds acceptable but which makes no allowance for the size of organization, maturity of fundraising program or other critical variable***. There is one grid regardless of the size of the charity and the 2 million dollar organization is expected to be as efficient and effective as the 200 million dollar organization. In addition, the grid is in percentages that severely constrain smaller charities and makes no allowance for the higher costs that are incurred by small and mid-size organizations that typically depend on much smaller donations.

The policy and the background materials are contradictory on the use of the grid. The policy states that charities will be ranked on the grid on the basis of an annual expense/revenue calculation and CRA auditors will use the grid in their audits. The background material, however, clarifies that the grid ranking would not be made public by the CRA. Charities could provide their fundraising costs in whichever form makes sense - a five-year average, an overall cost for their capital campaign, or information on costs by the different types of fundraising, etc. This flexibility makes good sense. A donor attending a gala, for example, would understand the expense ratio would be high, especially as they only receive a tax receipt for a portion of the ticket. Should the gala costs be included with the individual request campaign expenses, this will distort and inflate the individual ask campaign costs, misrepresenting to the donor the charity's fundraising costs for his gift.

Some small and medium charities, particularly the newer ones that serve specific populations as well as charities in small communities, may never be able to reduce their fundraising costs to levels the CRA has defined as acceptable (under 20% acceptable, under 35% generally acceptable, 35.1-49.9% potentially not acceptable, 50-70% generally not acceptable, more than 70% rarely acceptable).

For example:

Charity A raises much of its funding by organizing community dinners for locals and tourists during the summer season. Every two weeks during June, July and August they host festival dinners down by the lake. Tickets are priced at $35 and are actively sought after. The charity provides tax receipts for $15.00 upon request. The charity's fundraising costs are over 50% and cannot be reduced but they clear $2,500 a night, employ a number of local youth and draw economic activity to the town.

Charity B finds its volunteers need administrative and organizational help raising the money they require for program. The charity hires a part-time staff person to help. This costs $35,000 a year plus 10% for statutory benefits and another 10% for office overhead. With out-of-pocket fundraising expenses the agency will spend $60,000 on raising funds. This means the fundraising staff and volunteers need to raise $300,000 every year to come in at the 20% expense/revenue ratio - something they are not likely to do. $150,000-175,000 is a more realistic average target for their community and they will only reach that after several years of building a community event and growing their direct mail returns. In their community $100 is a large donation. Their target is to clear 50 cents on the dollar and this increased revenue will allow them to double their service capacity and help twice as many families.

As the examples above illustrate, assessing and evaluating fundraising costs is complex and highly variable. The "one size fits all" sweep of the guidelines risks placing in jeopardy many activities that benefit local communities and over simplifies the complex and variable cost structures that underlie the different methods and approaches to fundraising.

On the one hand, Government is encouraging individual donations as the preferred funding source and, on the other hand, they appear to be constraining charities' ability to go after those funds. Fundraising is expensive. When is it too expensive? Who decides? And if it proves too expensive what other options do small and medium charities have to undertake their important work?

6.   ***CRA intends to conduct audits and revoke the charitable status of charities that have excessive fundraising costs***. Extenuating circumstances and judgments regarding the appropriateness of the costs under the guidelines will be for the CRA auditor to determine but it is not clear on what basis they will make that decision. How will they determine fundraising costs are too high?

Moreover, what will the costs be for CRA to train, advise and monitor the implementation of these very complex and complicated guidelines in the thousands of small and medium charities across Canada. Will this divert resources from going after the truly fraudulent charities and fundraising scams? Could targeted regulation be more effectively and efficiently aimed at specific areas of concern?

Conclusion

Fundraising regulation must be clear about the goals it intends to accomplish and ensure that the regulatory regime achieves the intended purpose without causing undue harm to Canadian charities.

We do not believe the CRA intended to impose on small and medium charities such complex and onerous reporting requirements. Nor do we think they understand how much they have expanded, inflated and complicated the definition of fundraising activity and expense in smaller organizations.

Data and research on fundraising by Canadian charities is very limited. For this reason, we do not believe CRA understands the "on the ground" realities of raising funds in local communities for small and medium sized charities.

We need to help CRA understand that small and medium charities cannot be collateral damage as CRA seeks to ensure the integrity of fundraising and charities in Canada.

RECOMMENDATIONS REGARDING CRA FUNDRAISING GUIDELINES

1. **Restrict the scope of fundraising expense guidelines to revenues eligible for a charitable tax receipt.**

2. **Recognize fundraising as a charitable expense, an essential element of charitable purposes, particularly for operating charities.**

3. **Develop a simplified reporting process for small and medium-sized charities.**

4. **Develop new, consistent and modern policies regarding earned income to make them a legitimate component of revenue generation for charities. Do not include costs to earn income with fundraising expenses.**

5. **Allow charities to report their fundraising costs to the public in a manner that will help the public understand the costs of different fundraising methods and approaches.**

6. **The following important guidelines be issued separately:**
    - **Ensuring True Charitable Purpose**
    - **Prohibiting Private Gain**
    - **Preventing illegal fundraising methods**
    - **Preventing misrepresentation**

7. **Fund research into fundraising activity in the charitable sector so we have the information to develop a more effective and responsive regulatory regime and identify the sector's strengths and challenges.**

PLEASE TAKE THE TIME TO RESPOND TO THESE CRA GUIDELINES.

YOUR RESPONSE NEED NOT BE COMPLICATED OR LENGHTY.

TELL THEM OF THE POTENTIAL IMPACT ON YOUR CHARITY AND THE WORK YOU DO.

SEND REPLIES TO: **consultation-policy-politique@cra-arc.gc.ca**

Or, by mail to:

Charities Directorate, CRA

Ottawa ON K1A 0L5

ONN and its partners in other provinces are working on a survey. When you receive it, please take the time to fill it out. We desperately need the data as we have no reliable information on the amount and type of fundraising and earned income activities undertaken by charities.