

Charities Respond to the Minister of Revenue

JOHN D. GREGORY

Member, the Ontario Bar and Editor, The Philanthropist

In November, 1990, the federal Minister of Revenue published a Discussion Paper in order to solicit public views on "A Better Tax Administration in Support of Charities". The highlights of the paper were summarized in (1990), 9 *Philanthrop.* No. 4 at pp. 55–59. Among the responses submitted to the Minister were submissions from three major representatives of the charitable sector in Canada: The Canadian Centre for Philanthropy (the Centre), the Coalition of National Voluntary Organizations (NVO), and the Association of Canadian Foundations (ACF). This article will outline the main points made by each of the organizations, following in general the order in which the government's Discussion Paper set them out.

The Organizations

The Canadian Centre for Philanthropy is a resource and advocacy organization serving 1300 member charities, large and small, across the country. It runs educational programs all year, and its annual conference is one of the highlights of its programs for those who want to sharpen their skills for working in the charitable sector.

The Coalition of National Voluntary Organizations is a less formal network representing the interests of Canada's registered charities and voluntary organizations. The NVO and its Executive Committee represent all regions of Canada and all areas of the charitable voluntary sector.

The Association of Canadian Foundations represents a cross-section of Canadian foundations both in terms of type—public foundations, including community and hospital foundations, and private foundations, and in terms of size—from a few thousand dollars in assets to many millions. It has 105 member foundations.

General Comments

The Centre found it difficult to react to the Discussion Paper, noting that it raised more questions than answers. It alluded to potential changes without giving a sense of the ramifications of the changes for the charitable sector. The Centre would have liked to organize consultation sessions for Ministry officials and associate members of the Centre to explore the issues, but the Ministry decided to review the written submissions it received before consulting in other

ways. The Centre maintains its offer of face-to-face meetings as the most productive method of developing policy.

The NVO alluded to the long history of charitable activities in the country, emphasizing not only their wide range of services to the entire community but their unique grassroots immediacy and flexibility. Charities, said the NVO, were not in competition with businesses or with government, but served different purposes. The charitable motives of its millions of volunteers distinguished the sector, particularly from other types of organization. The NVO thought, as did the Centre, that more personal consultation would have been helpful for the policy process and anticipated a good deal of such consultation in later stages when legislation was being developed.

The ACF agreed that the language of the Discussion Paper did not permit detailed and specific comments and asked to have the opportunity to consider draft legislation when the Ministry had developed it.

All three organizations welcomed the spirit of openness and communication promoted by the Ministry and supported the Ministry's declared intention of clarifying the law and providing for accountability by charities to the public they serve. The NVO submitted that the public interest was best served when charities were self-governing and accountable directly to their communities, though it did not spell out how this could be arranged. It did say that the benefits of full disclosure would be lost if too much detail were required, if deadlines were too tight, or if duplication were not avoided. Publishing registration decisions would be helpful, but publishing deregistration decisions before all appeals were disposed of could cause serious harm to charities that ultimately demonstrated their right to remain on the register.

Defining a Related Business

The Discussion Paper proposed to restrict charities in carrying on business, notably by prohibiting substantial commercial endeavours that would compete unfairly with private businesses and by limiting charities to "related" businesses that had been carried on "for some time". The proposals raised concerns among all three organizations.

The Centre wanted to know the test for "substantial commercial activity", and how long "some time" was:

The example in the [Discussion Paper] regarding hospital parking facilities is self-explanatory. However, would this also apply to a hospital tuck shop run by volunteers from the hospital auxiliary where the proceeds go directly to the hospital's foundation? Are church bingos exempt? Are service clubs, such as the Optimists and the Lions Club or the Rotarians, which organize fund raising events for charitable causes, considered competition to potential private sector interests? Could they eventually

be disallowed from performing these services which generate charitable dollars at a time when governments are cutting back funding?

The NVO also wanted to know what commercial activity was, and when it became substantial:

Today there are few traditional charitable activities not also undertaken by the private sector, with the possible exception of feeding the needy. Charities have long been involved in recreation, education and youth development, health and social services, arts and culture, and primary medical research.

The Discussion Paper appears to assume that charities are engaged in business for its own sake, rather than to raise funds for charitable ends. . . . Charities engage in business for only one reason—to raise money for charitable purposes, money that would not otherwise be available. Charities are not in business to compete with for-profit companies—working to maximize returns to principals and shareholders. [The fact of competition] . . . therefore rests on an invalid premise.

The NVO was also concerned that limiting businesses to those in operation for some time “would effectively create a closed shop for commercial charitable activity, limiting from the outset activities of newer organizations and restricting new initiatives by older charities”. It doubted that the Ministry had intended this.

NVO doubted in fact that business activities of charities were a problem at all and asked why the question had become a priority.

The ACF noted that related businesses were not a concern of private foundations but did touch public foundations, especially hospitals and educational institutions. While the ACF was content with limits on substantial commercial activity (though it, too, wanted a definition of “substantial”), it did not agree with the “no competition” rule or the “in business for some time” limit and asked that they be deleted. The first would be very difficult to demonstrate one way or the other. The “for some time” rule would preclude any new business activity or initiative. “We believe this to be unfair to charities contemplating new ways to raise needed revenue.”

Disclosing the Cost of Fund Raising

The Discussion Paper suggested increasing disclosure of the amounts spent by charitable organizations on fund raising. The Centre had no problem with such a requirement. The NVO agreed that “greater transparency for fund raising costs” was desirable and could only enhance the credibility of the sector. It was concerned that this not create “an unsupportable paper burden”.

Having to identify fund raising expenses for each activity during the year would create such a major burden for many charities. Separately accounting for expenses related

to activities such as bake sales, apple and bottle drives, fun runs and marathons, tag days and flower sales, and “celebrity” auctions would be an onerous task, especially for the volunteer accountant.

It would also be helpful to know how much fund raising information government might want charities to provide and in what detail. For example, would only direct expenses be required or would overhead also have to be broken down?

If the primary objective is to identify the portion of charitable donations being spent on private sector consultants, perhaps that information could simply be requested without adding to everyone’s paper burden.

It is important that some flexibility be maintained on fund raising costs. Newer charities or those launching a first campaign in a different medium might, in the beginning, incur expenses that appear disproportionately high but which are adequately amortized over time.

The ACF pointed out that few private foundations were engaged in fund raising, but that public foundations would be affected by new rules. “We find no reason to object to the government requiring charities to provide more information about their fund raising costs.”

However, a clear, concise definition of what expenses constitute fund raising costs is required in order that all charities are recording such costs in the same manner. Any new provisions must recognize the higher fund raising costs that would be incurred by a newly established charity, fund raising for the first time or an established charity seeking funds for a new venture. These charities should not be penalized because of a higher than normal ratio of fund raising costs to funds raised.

Accumulation of Funds and the Expenditure Test

The Discussion Paper indicated that the Ministry felt the present rules allowing charities to accumulate funds, and the calculation of compulsory expenditures on charitable activities, were inadequate. The Centre proposed further review of the work done by tax authority Arthur Drache in the late 1980s on the subject. The government should show more flexibility in this “business related area”:

If the government becomes too restrictive [about what must be spent on charitable activity], many charities will revert to becoming advocacy groups. If the government asks charities who now provide quality volunteer services to the public to tighten up the regulations to such an extent that they are limited, they will have no initiative at all to generate revenues. This would be extremely self-defeating.

The NVO did not discuss this topic. The ACF on the other hand discussed it at length, particularly as it affected foundations. It admitted that the law on accumulation of funds was flawed but said that the Ministry’s proposal did not repair the flaw.

The ACF used an example to demonstrate its point, a charity with Ministry permission to accumulate \$100,000 a year for three years. Under present law, its normal expenditure requirement would be reduced by that amount in each year that funds were accumulated; however, the law was now unsatisfactory since it did not specify how the accumulated funds themselves were to be spent for charitable purposes in the fourth year:

Under current law, the foundation would spend the accumulated \$300,000 in year four and [that expenditure] would go to meeting the disbursement quota of that fourth year. . . . If the normal disbursement quota was \$400,000, the charity would then have to spend [only] \$100,000 additional funds to meet the . . . quota. Consequently, the charity has now saved itself \$300,000 in disbursements because it had accumulated these funds.

The Revenue Canada solution is to include those accumulated funds as received donations in the year in which they are spent. [This] . . . would mean that the charity [in the example] would be deemed to have received an additional \$300,000 in donations in year four. As the rule on received donations is that 80% of them must be spent in the following year, . . . in year five the disbursement quota would be \$240,000 higher than normal (80% of \$300,000). The first thing wrong with [the Ministry's] solution is that the charity still ends up being able to retain 20% of the amount it had accumulated. . . . Secondly, is the charity would now have to increase its normal giving or charitable activity in order to meet the higher disbursement quota in year five.

The ACF recommended that the disbursement quota be increased for the year in which the accumulated funds were spent, by the amount spent. Then:

. . . all of the accumulated funds which had been deemed to have been used to meet the disbursement quota in the first three years would finally be paid out to charity or used in charitable activity, and it would leave the charity in our example having paid out over the four years in total its normal minimum disbursement quota.

The ACF was concerned that Revenue Canada's proposal included all exclusions from the expenditure test, i.e., not only accumulations but also amounts received as testamentary gifts or subject to a requirement that the amounts be held for at least 10 years. The ACF noted that the present rules about expending these funds are also flawed, for reasons similar to those governing accumulations, namely that the amount excluded from compulsory disbursement is never made up. "We recommend that when a ten-year gift or a testamentary gift is expended, the amount . . . should be deemed to be a receipted donation of the year prior to the year the amount is expended, not a donation of the year when it is expended, as Revenue Canada proposed." Then the required spending would fall in the year of the actual expenditure.

The ACF pointed out that it was not aware of any foundations spending 10-year gifts or testamentary gifts.

From our standpoint the problem is purely academic. We also cannot stress too strongly that the basic provision allowing for such gifts to be held in perpetuity should not be changed.

Tax Receipts

The Discussion Paper proposed that the rules for issuing tax receipts not be relaxed. The Centre agreed. It was pleased to note that performance contracts and other arrangements which secure expenditure responsibility by a Canadian charity in an acceptable manner would now be allowed.

The NVO did not comment on this question. The ACF agreed with the maintenance of the current rules. It also recommended that Revenue Canada should monitor more closely the tax receipts filed by individual taxpayers in support of charitable tax credits, not because of dishonesty on the part of the taxpayer, but because of the danger of deregistered charities continuing to collect donations and issue tax receipts.

The ACF also asked for formal clarification of the question of whether a charity should issue a tax receipt to a foundation that gives it a donation. Instructions from Revenue Canada had been inconsistent on the point.

Charities Abroad

All three groups agreed with the thrust of Revenue Canada's proposals on charities abroad, to increase public confidence that these donations were going to acceptable recipients. The NVO repeated its concern about the burden of reporting extra detail, in this case about offshore activities of charities carrying on activities abroad.

Political Activities

All three groups also supported the Ministry's proposal to clarify the rules on acceptable political activity for charities. The Centre was happy with the 1986 rules. It felt that partisan political activity should continue to be banned. New public information explaining "education, advocacy and non-partisanship" would be welcome. "Greater detail on annual returns about political activities is also in the best interests of the sector."

The NVO volunteered to help develop explanatory materials on this subject. "Both advocacy and non-partisan political activity by charities when congruent with their mission is legitimate. The public interest can be well served by the educational work of charities in their areas of expertise." The NVO wanted to know if a charity accused of political activity would have the same right to appeal as that available for technical breaches of the *Income Tax Act*, and if

there was a formula or fixed percentage of resources that a charity might legitimately use for so-called political activity. It was concerned about added paperwork on annual returns on this subject as with others.

The ACF welcomed clearer definitions and accepted the need for additional information on the annual returns. It emphasized the importance of distinguishing between partisan political activity and “advocacy on behalf of a cause or a group of citizens with a special need”.

Public Accountability

The Centre supported using annual returns to make information available to the public, and the current time limits for filing them. It was concerned about requiring smaller organizations with budgets under \$250,000 to have a formal audit of their statements. It urged the Ministry to consider a financial penalty rather than deregistration for late filing of the returns. It wanted to know what would constitute “reasonable notice” of impending sanctions. “We are pleased that the government has indicated its willingness to work closely with the charitable sector to identify common causes of non-compliance of both minor and major nature.”

The NVO agreed that openness contributed to public confidence but warned that measures designed to encourage openness could have the opposite result. Information on proposed revocations should not be made public until all appeals had been ended. On technical points the NVO agreed with the audit requirement and with accommodation for smaller charities. It offered to collaborate in developing standard forms for reporting. It had reservations about requiring audited statements within six months of year end, on the basis that the cheaper, off-peak accounting services used by many charities might not be able to meet such a schedule. It also doubted the general six-month filing deadline, especially if sanctions were going to be imposed more frequently. Charities selected by Revenue Canada for special audit should be informed of the reasons and the process ahead of time, as well as of the possible penalties if breaches of the rules were found.

The ACF was concerned about possible invasions of privacy, for example for people about to set up foundations. Trust companies and lawyers with expertise in this area should be consulted before present confidentiality provisions were relaxed. Further, the ACF was not comfortable with disclosing individual salary figures in the Public Information Return. “Most staffed foundations have only one paid executive officer, and thus stating salary clearly identifies that officer’s remuneration. Salary disclosure is not required from Canadian public companies and should not be required of charities.”

The ACF agreed that audited financial statements should be required, but said that such a requirement should only apply to those with assets over a certain

threshold. Most foundations were small, and requiring an audit of, say, those with over three million dollars in assets would relieve three quarters of existing foundations from the audit. The ACF also urged that reporting requirements of the Public Trustee of Ontario be co-ordinated with the federal requirements, to avoid duplication of effort.

The ACF suggested different filing guidelines for small and large foundations. Guidelines for reinstatement should be simple, so that charities inadvertently deregistered could become registered again without great costs. The rules for valuing assets being disposed of on deregistration were, however, objectionable. Revenue Canada proposed valuing the assets at:

... the highest value obtained in a period beginning 120 days before the charity receives notice of revocation. . . . There could arise a situation where a charity which had substantial holdings in the stock markets could have that value adversely affected by a sudden drop in market values as we all encountered in October 1987. Revenue Canada would need to take that type of unforeseen circumstance into account when determining the asset value.

Conclusions

The Centre supported the tenor of the Ministry's suggestions:

If the changes proposed are intended to make the system simpler and more comprehensible without compromising its effectiveness, then the charitable sector will welcome [them]. If, however, the result is a more complicated form, more restrictions on related business activities, more rigidity on filing restrictions and more expense on audited statements at all levels, there will be a backlash and negative devolution of much of the goodwill, honesty and emphasis on voluntarism throughout the country. Stagnation and increased dependence on government support will occur at a time when diminished economic expectations are definitely the order of the day.

The Centre offered its continued collaboration to ensure positive results from the process.

The NVO looked forward to "greater understanding and enhanced credibility" from the proposed reforms:

We trust that the regulations are not being amended simply to deal with a small minority of offenders at the expense of the majority of sincere and hard-working charities who fulfil such a necessary role in our society and our economy.

Both the NVO and the ACF volunteered their availability for further consultation on the subjects raised in the Discussion Paper.