



Canadians want non-profit transparency and charitable donations to benefit legitimate charities

**Submission to the House of Commons Standing
Committee on Finance on Motion 559**

May 1, 2012

Dear Members of the Standing Committee on Finance,

Blumberg Segal LLP is a law firm based in Toronto that provides legal services to Canadian non-profits, registered charities and donors. Blumberg Segal LLP maintains websites, <http://www.canadiancharitylaw.ca> and <http://www.globalphilanthropy.ca>, that provides extensive information and resources to Canadian charities to encourage them to comply with their legal obligations and strive for higher ethical standards. We also encourage donors to be generous but careful in the way they practice charity and philanthropy. Our firm is concerned about the well-being of the non-profit and charitable sector.

With the Standing Committee on Finance studying charitable donation incentives and other issues facing the charity sector we are pleased that you have provided us with an opportunity to present on May 8, 2012.

Summary

Canada's system of registered charities provides the most generous tax support for charitable donations of any country in the world. While this generosity has helped strengthen the sector, it has also resulted in various people exploiting charities for their tax benefits. We wish that this was an isolated problem but as we will explain below, it is not. We are concerned that with the current generous tax incentive system there are not adequate measures in place to provide transparency and prevent the misappropriation of charitable assets. By providing further tax incentives without enhancing the safeguards and transparency available to donors, it will be more difficult for charities to protect themselves from promoters, professional advisors and others that wish to abuse the privileges accorded to the sector.

While in some countries there are proposals to dramatically reduce or eliminate tax incentives for donations at a national or state level, we are pleased that this is not the case in Canada. However, we are concerned that token increases in tax incentives may be used as a partial justification for various levels of government to cut funding provided to charities, as has been done in the past. While making changes to current tax incentives may be useful, it is much more important to focus on preventing the exploitation of charities that often leads to a precipitous decline in public trust. Reducing the abuse of charities will be beneficial for the overall reputation of the charitable sector. It could also save the federal and provincial governments

significant tax revenue which could subsequently be redirected to other priorities, including funding of the sector.

Introduction

According to the T3010 Registered Charity Information Return data from CRA, the charity sector has a total combined revenue of approximately \$192 billion per year¹. From 2000 to 2009, that number rose by approximately 94%. The charitable sector obtains this revenue from several different resources; \$133 billion from various levels of government, \$46 billion from earned or business income, and \$13 billion from received donations. The amount of received donations has actually increased by 35% from 2003 to 2009. Currently, about 7% of the charity sector's revenue is a result of charitable donations and fundraising. This is why it is important that measures taken to provide for extra donations do not undermine the ability of government to continue funding the charitable sector. For example, if various levels of government decided to reduce their funding of the sector by 10%, the sector as a whole would need to fundraise twice as much to account for that difference.

Transparency

The work that charities do is extremely important to our society, so it is vital that various stakeholders, such as the public, the media, the government, donors, employees, boards etc. have access to key information on what the charity is doing and how it is doing it. Transparency will ultimately increase public trust and confidence in the sector by making the public more informed about the work of charities and making it more difficult for people to misuse charities. However, there are a number of legislative impediments to transparency that currently exist. The confidentiality provisions of the *Income Tax Act* (Canada) prohibit those who know about current abuses (such as the CRA) from informing the public or anyone else, except in very narrow circumstances and often many years after the problem has occurred. The public, whether through donations, paying taxes or buying products from charities, should be provided with up to date and relevant information on charities. Expanding the scope of disclosure allowed with respect to registered charities under the *Income Tax Act*, has no costs associated with it and will result in tens of millions of dollars moving from charities involved with abusive schemes to charities involved in real charitable work.

What are some of the problems in the charitable sector?

According to the CRA, over the last eight years there have been approximately \$5.7 billion dollars in donation receipts issued as part of "abusive charity gifting tax schemes". Approximately 1% of this amount was spent by these few registered charities on charitable activities and over 175,000 tax returns have also been filed as part of these schemes. Many of these gifting schemes involve a taxpayer receiving a higher tax receipt than the actual amount of their donation. For example, investing only \$1000, but receiving a \$5000 donation receipt. Over 100,000 Canadians have also filed tax returns with what CRA refers to as 'fraudulent receipting'. In addition, there have been several other elaborate schemes used to abuse

¹ http://www.globalphilanthropy.ca/index.php/blog/category/canadian_charity_statistics/

receipting privileges. A number of Canadian² and foreign journalists³ have covered some of the misuse of Canadian registered charities and our firm has provided information to the public about some of the abuses.

The Toronto Star⁴ has reported one Canadian registered charity, ORNGE, which provides air ambulance services in Ontario. ORNGE provides an example of how affiliated non-profits can be used to hide transactions that some charities are involved with. It shows how weak governance can result in poor decision-making. It also shows the extensive use of professional advisors in structuring complicated transactions. The amounts involved with ORNGE are relatively small compared to some other charity abuse but it provides many highly visible opportunities to learn.

Does the public care about transparency of charities and non-profits?

There is tremendous public concern about the conduct of some non-profits and registered charities. Recent polling by Ipsos-Reid shows the public overwhelmingly wants more information about charities, their programs, fundraising costs and impact:

“Canadians continue to place great importance on the information charities provide to the public. Almost all Canadians think it is important (very or somewhat) for charities to provide information on how they use donations (98%), information about the programs and services the charities deliver (98%), information about charities’ fundraising costs (97%), and information about the impact of charities’ work on Canadians (96%).”

Confidentiality Provisions of the *Income Tax Act*

The non-profit and registered charity sector is essentially divided into two. While non-profits and registered charities are both exempt from paying income tax, only registered charities, and some other categories of qualified donees, can issue official donation receipts for income tax purposes. Currently, the confidentiality provisions in Section 241 of the *Income Tax Act* (Canada) forbid the Canada Revenue Agency (“CRA”) from disclosing information about any non-profit or registered charity either through an informal request or a formal access-to-information request. The only way this information can be accessed is if it falls within certain narrow exceptions, such as the public part of the T3010, or if there has been consent for disclosure provided by the non-profit or registered charity.

² For example, Kevin Donovan of the Toronto Star, Paul Waldie of the Globe and Mail, and David Baines of the Vancouver Sun.

³ For example, Caroline Preston of the Chronicle of Philanthropy.

⁴ <http://www.thestar.com/topic/ornge>

Registered Charities

Currently, without the consent of the registered charity CRA can only provide the “entirety of or any part of any letter sent by or on behalf of the Minister to the charity relating to the grounds for the revocation or annulment”. However, this can only be provided after the charity’s registration has been revoked. This means that by the time the charity has actually lost its registered charity status, several years may have passed after CRA started having significant concerns about the charity. Therefore, CRA essentially has no ability to disclose to the public any information about charities that are involved with abusive gifting tax shelters (totaling approximately \$5.7 billion dollars over the last 8 years). CRA also does not have the power to disclose to the public any information surrounding charities that have had complaints of systemic child abuse, involvement with inappropriate third party transactions or other major concerns. Accordingly, we welcome the 2011 Federal budget changes that provide CRA with the ability to release certain basic information on certain qualified donees (for example, RCAAAs). We also welcome the 2012 Federal budget changes that allow the suspension of a charity that fails to report information on its annual return. The public, especially donors, should have the right to know of any serious non-compliance by charities and it will take amendments to the *Income Tax Act* to allow for such disclosure.

Recommendation: S. 241 of the *Income Tax Act* should be amended to allow the CRA to disclose serious non-compliance with legal requirements by a registered charity, Registered Canadian Amateur Athletic Associations or certain other qualified donees.

Non-Profit Organizations

It is estimated that there are over 80,000 non-profits that are not registered charities or other types of qualified donees in Canada. They are exempt from almost all transparency requirements even though in many cases, they receive government funding, support or public donations. Prior to the introduction of the *Canada Not-for-profit Corporations Act* (CNCA), non-profits did not have to publicly disclose their finances, such as revenues, expenditures, compensation and programs. With the CNCA now in force, financial statements of certain Federal non-profit soliciting corporations may need to be disclosed. However, this rule does not affect provincial non-profits, Federal non-profits under the old *Canada Corporations Act* or Federal non-soliciting corporations under the CNCA. While non-profits that are not charities must in some cases file the two page Form T1044, Non-Profit Organization (NPO) Information Return, such form is not made available to the public either electronically or by request. In essence, except for the limited disclosure under the CNCA, there is no transparency for these non-profits in Canada.

Recommendation: S 241 of the *Income Tax Act* should be amended to allow the CRA to disclose information contained on the Non-Profit Organization (NPO) Information Return.

Other Suggestions On Funding the Sector and Increasing Trust in the Sector

There is a big difference between bringing more money into the charitable sector versus actually having more funds spent on real charitable activities. Do we want to increase the investment portfolios of the foundation sector or do we want funds to be spent on charitable activities? They are not necessarily the same thing. There are many ways in which the total amount of charitable donations can be increased while ensuring that these donations are actually spent on beneficial charitable initiatives including:

- 1) Making small changes to the disbursement quota to increase the payout from 3.5% to 5%, so hundreds of millions of dollars can be used for charitable programming that would have been otherwise an unauthorized encroachment on capital;
- 2) Requiring charities to demonstrate (as in the UK) that they are active and actually have a “public benefit”, rather than this being assumed, which could help the sector tremendously by increasing public confidence, and reducing the number of dormant charities;
- 3) Increasing the capacity of the sector to understand their compliance obligations and help donors understand the importance of carefully selecting charities and avoiding scams;
- 4) Having a review of the T3010 to encourage greater disclosure of information to the public, as has been done in the US with their annual return or the UK with their reporting;
- 5) Making greater use of police forces to investigate abuse of charities and establishing a dedicated police unit that focuses on complicated schemes involving charity fraud.
- 6) Monitoring the implementation of the “ineligible individual” rules, and if these rules are not sufficiently effective in removing those who abuse charities, or their beneficiaries, then considering additional measures.

Political Activities by Canadian charities

There has been quite a bit of attention focused on political activities by Canadian charities over the last few months. It is important to recognize that while charities are forbidden from being involved in partisan political activities, they play an important role in policy and political discussions. Registered charities can engage in allowable political activities as long as they are non-partisan, related to their legal objects and limited resources are used (generally less than 10% of resources).

Charities bring knowledge, experience and resources to public policy issues. Having a conversation about the future of health care would be inadequate without hospitals. Having a conversation about education would be insufficient without input from the schools and universities. Having a discussion about legislation relating to religion would be unfortunate without any churches, mosques, temples and synagogues allowed to speak on these issues.

Some subjects, such as reducing impaired driving, are almost impossible to tackle without political changes. The conversations that take place in the political space are important and it is vital that charities participate in those discussions. It would be ineffective and inefficient for charities to be working on improving society without being involved with the political process.

That being said, Canadian charities can certainly improve their reporting on political activities. We have written on T3010 disclosure of political activities and how such disclosure by charities can be improved⁵. Many charities and parliamentarians are unaware or misinformed of these rules and requirements. Enhanced educational initiatives by the CRA will assist charities in understanding their legal obligations with respect to various issues, including political activities. Many charities are misinformed about the rules and think charities must avoid all political activities. When the rules are explained to charities and they realize they can engage in allowable political activities, this may increase the number of charities engaging in political activities to achieve their mission and ultimately this will make charities more engaged in the political process and more effective in achieving their charitable mission.

Despite the surrounding discussion, the 2012 Budget will have little impact on charities and their involvement with the political process. The law as it stands allows for registered charities to be involved with allowable political activities and we would not suggest that there be any further limits on such political activities.

New incentives for charitable giving

Studies have shown that most people give to charities for predominantly non-tax reasons. For example, they are passionate for a cause, they want to have an impact, they feel an obligation to help their community, or they are asked by the right person. Yet over the last 15 years, there have been a plethora of different tax incentives introduced that prefers donations of certain assets over cash donations. It is not clear that these tax incentives are always bringing new money into the sector. In many cases the donor would have given cash but if a preference is given for a type of gift in kind they will adjust their giving so as to make the after tax cost of the large donation less. This has in some cases increased the complexity of giving and skewed the tax advantages in a way that is far more beneficial to certain Canadians rather than the average Canadian donor. It seems odd that a small subset of the most affluent in our society may receive even more tax savings under some proposals in the current state of our economy.

It is interesting to note that approximately \$12 billion per year is sent by people resident in Canada to their family and friends abroad as remittances⁶. This means that a small, typically poor group of people in Canada is sending more money to typically poor recipients in the developing world than the entire amount of all donations made by Canadians to charities in Canada. At this time, there is no government subsidy for these remittances.

With respect to donations of private company shares or real estate, it is important to recognize that there is a significant potential for manipulation, especially private company shares. Charities are often not aware of the complexity of these types of assets. The CRA recently

⁵ "How accurate are the T3010 charity returns when it comes to political activities?" by Mark Blumberg

http://www.globalphilanthropy.ca/index.php/blog/comments/how_accurate_are_the_t3010_registered_charity_information_returns/

⁶ http://www.canadiancharitylaw.ca/index.php/blog/comments/2010_hudson_report_index_of_global_philanthropy_and_remittances_-_people_in/

revoked four charities for their involvement in just one private donation share scheme and we are concerned that further tax incentives for this kind of donation will create additional incentives to encourage the misuse of charities for private company share donations. Providing additional incentives to high net worth individuals to donate certain types of assets could result in a backlash against charities and reduce tax incentives for the general public. It is important that if any changes are proposed which would provide additional tax incentives, that adequate protections are put in place to prevent any misuse of these kinds of benefits.

In order to make more funds available for the charitable sector, the focus should be on eliminating the harmful behavior by a small number of charities that is undermining the public confidence in charities. Not only will this save a large amount of money for both the government and taxpayers, but maintaining or increasing public confidence in the charitable sector will lead to more donations, irrespective of the tax incentives provided. Furthermore, all levels of government must be made aware of the negative effects of cuts in grants and contributions to registered charities, especially those that serve the most vulnerable. We do not consider such cuts inevitable – cuts are a policy choice.

Cross-Border Giving

Canadian charities receive approximately \$831 million in revenue from outside of Canada⁷ according to the current T3010 filings. This accounts for less than 0.5% of the total revenue of Canadian charities. Canadian charities spend about \$2.6 billion outside of Canada, which is about three times more than the amount of funds coming into Canada.

Consequently, we should be encouraging those outside of Canada who are interested in the work of Canadian charities to support our charities. Some of our charities are world-renowned and dealing with globally significant issues and it is not surprising that foreign foundations and individuals would want to support them. The needs of Canadian charities are immense and if one is thinking from a taxpayer perspective Canadian taxpayers do not subsidize donations from foreign charities.

While we are not concerned with increased transparency around foreign funding of political activities in Canada as contained in the 2012 Budget, we think that it is a distraction from the important transparency needs of the donors and the sector. In fact, the new information CRA will probably be requesting is largely already publicly available by reviewing the Form 990 of certain US foundations at Guidestar⁸. Canadian charities already had to disclose whether they received any foreign funding (even as little as \$1) and at www.canadiancharitylaw.ca we provided information on charities receiving foreign funds. As well, any charity that receives over \$10,000 from a foreign source must confidentially disclose to the CRA detailed information on such funding in their T3010 annual return.

⁷ “So how much do Canadian charities receive from foreign sources according to the T3010 Returns?” by Mark Blumberg http://www.globalphilanthropy.ca/index.php/blog/comments/so_how_much_do_canadian_charities_receive_from_foreign_sources_according_to/

⁸ <http://www.guidestar.org/>

The increased transparency requirement, which only applies to registered charities, further reinforces the unfortunate gap between disclosures made by registered charities compared to non-profits. Many non-profits who are not registered charities are receiving foreign funding for various legitimate and perhaps other purposes, yet they have no obligation to publicly disclose any information about their operations. When CRA discovers a Canadian registered charity is involved in some form of non-compliance, such as terrorism, CRA can deregister the “charity”. However, after deregistration, the group can continue operating as a non-profit, but ironically there is no information provided to the public on its subsequent activities as a result of the lack of disclosure requirements for non-profits.

Although not discussed much, in its 2012 budget the Federal government has made changes to the category of qualified donee called “Gifts to Certain Charitable Organizations Outside Canada”⁹. There are currently nine foreign charities on that list. We are hoping that these clarifications will be helpful in the long term and could result in a large number of reputable foreign charities that are involved with disaster relief, urgent humanitarian aid or “carrying on activities in the national interest of Canada” being added as qualified donees over the next few years with an increase in international philanthropy.

In terms of money leaving Canada as part of international philanthropy or foreign activities, CRA has detailed rules about Canadian charities operating outside of Canada¹⁰, which provide practical guidance to charities on how to conduct work outside of Canada. We have also provided additional resources to assist charities in complying with their obligations for foreign activities and preventing the misuse of resources¹¹.

We are hopeful that Canadian charities will continue to be successful in fundraising outside of Canada. We would not suggest any further restrictions on foreign funding of Canadian charities or Canadian charities funding work outside of Canada.

Conclusion

The voluntary sector in Canada plays a vital role in this country. It provides some of the most important services and helps the most vulnerable. Over 600,000 Board members volunteer their time, effort, energy and skill to running registered charities. According to Statistics Canada, 13.3 million people, or 47% of the population, volunteered their time through a group or organization. These volunteers contributed nearly 2.1 billion hours in 2010 – a very valuable contribution to the work of the voluntary sector by Canadians which is generally not reflected in financial statements. The charity sector in Canada has 24 million donors¹². Also over 2.2 million people work in the charity sector.

⁹ <http://www.cra-arc.gc.ca/chrts-gvng/qlfd-dns/qd-lstngs/gftfrmhrmjsty-lst-eng.html>

¹⁰ Canadian Registered Charities Carrying Out Activities Outside Canada <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/tsd-cnd-eng.html>

¹¹ CRA’s New Guidance for Canadian Registered Charities Carrying out Activities Outside Canada http://www.globalphilanthropy.ca/index.php/blog/comments/cras_new_guidance_for_canadian_registered_charities_carrying_out_activities/

Within the charity sector, about 500 people are involved in most of the abuse.¹³ Will we let them continue to hide under the glow of the sector? In some cases those abusing charities are professional advisors such as lawyers, accountants and investment advisors. Sometimes those abusing charities have lots of assistance from professional advisors who are eager to assist and protect them when they are discovered. There are some who are good at creating the schemes. There are some who are good at implementing the schemes. There are some who would ‘never’ conduct the scheme but are very good at fighting for the charity to continue as a registered charity to continue issuing inflated receipts. There are some who are involved in all of these activities.

What does transparency do? It cannot guarantee the end of abuse of charities. It does not necessarily guarantee that charities will be accountable. However, it can shine a light of certain charities, which will hopefully help to reduce the amount of abuse that goes on. People are less likely to abuse charities if they know that they will be more easily discovered.

We need real transparency in the non-profit and charitable sector and to level the field. There are many great organizations that work hard at being transparent. Others are not interested in transparency and fight hard to prevent disclosure of their transactions and affairs. Secrecy breeds mistrust and lowers public confidence in the non-profit and charitable sector. The *Income Tax Act* should be amended to allow greater disclosure of information on Canadian non-profits and charities. We anticipate that there will be little or no fiscal cost for the adoption of the transparency recommendations.

Regardless of the outcome of the final recommendations to change the tax incentives, we hope that it will include measures to increase transparency, prevent inappropriate receipting and misappropriation of charitable assets. Otherwise, a few individuals may continue abusing the system at the expense of the charitable sector and all taxpayers.

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¹³ I was told by this by one Finance official at a Budget lockup in 2011 that about 500 people are causing 90% of the most egregious behavior. It is just an estimate but it is clear that it is a very small number in relation to the total number of people involved with the charity sector.