

# NPO SECTOR REVIEW

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# NPO Sector Review

## PURPOSE

The purpose of this sector review is to demonstrate that Canada has assessed its domestic NPO sector, and acquired a good understanding of the types of organizations operating within it. This has enabled it to identify those that may be at greater risk of terrorist financing abuse, and apply mitigating measures accordingly.

The Financial Action Task Force (FATF)'s Interpretive Note to Recommendation 8 indicates that countries should undertake a domestic review of their NPO sector, or have the capacity to obtain timely information on its activities, size and other relevant features. In undertaking these assessments, the FATF notes that countries should "use all available information to identify features and types of NPOs, which, by virtue of their activities or characteristics, are at risk of being misused for terrorist financing".<sup>1</sup>

Over the years, studies and analyses have been conducted on different components of the NPO sector in Canada by governmental, academic and non-profit organizations. These include:

- *The National Survey of Non-profit and Voluntary Organizations*<sup>2</sup>;
- *The Canadian Non-profit and Voluntary Sector in Comparative Perspective*<sup>3</sup>;
- *The Satellite Account of Non-profit Institutions and Volunteering*<sup>4</sup>; and
- *The Non-Profit Organization Risk Identification Project Report*<sup>5</sup>.

As part of this sector review, the Canada Revenue Agency (CRA) reviewed these existing publications and consulted other research related to the sector. Canada specifically sought to ensure that it was not taking an overly broad interpretation of the FATF definition of NPO, and that it focused on those organizations at greatest risk, without burdening others with onerous reporting requirements for terrorist financing purposes.

This review examines the size, scope, and composition of the entire NPO sector in Canada. The legal structure and reporting requirements of organizations within the sector are then discussed. Taking into consideration the findings of the FATF report on the *Risk of Terrorist Abuse in Non-Profit Organisations* (hereinafter referred to as the "Typologies Report") and Canada's National Risk Assessment, this document compares the Canadian NPO sector to the FATF definition of NPO to identify the types of organizations that may be at greater risk of terrorist financing abuse and therefore subject to Recommendation 8..

<sup>1</sup> FATF, "Interpretive Note to Recommendation 8" in *The FATF Recommendations*, 2012, available online at [http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF\\_Recommendations.pdf](http://www.fatf-gafi.org/media/fatf/documents/recommendations/pdfs/FATF_Recommendations.pdf).

<sup>2</sup> Statistics Canada, *Cornerstones of Community: Highlights of the National Survey of Non-profit and Voluntary Organizations* (Ottawa: Minister of Industry, 2005).

<sup>3</sup> Michael H Hall et al. *The Canadian Non-profit and Voluntary Sector in Comparative Perspective* (Toronto: Imagine Canada, 2005).

<sup>4</sup> Statistics Canada, *Satellite Account of Non-profit Institutions and Volunteering* (Ottawa: Minister of Industry, 2007).

<sup>5</sup> CRA, "Non-Profit Organization Risk Identification Project Report", 2009, available online at <http://www.cra-arc.gc.ca/tx/nnpftr/nprft-prjct-rprt-eng.html>.

## INTRODUCTION

Canada has one of the largest NPO sectors in the world, comprising of approximately 180,000 organizations. These organizations carry out a wide range of activities and programs in areas such as health, religion, education, the arts, social services, and recreation. These activities take place at national, provincial, regional, and community levels. In 2010, the sector contributed over \$176 billion to Canada's gross domestic product (GDP), which accounts for approximately 8.1% of the national economy.<sup>6</sup> It may be worthy to also note that it employs nearly 12% of the economically active population,<sup>7</sup> and relies substantially on volunteer labour, with data indicating over 500,000 full-time equivalent volunteers.<sup>8</sup>

## DEFINING THE CANADIAN NPO SECTOR

From a regulatory perspective, the NPO sector can be divided into two groups, 'charities' and 'non-profit organizations', depending on the legal structure of the organizations. While both are exempt from paying taxes, organizations that qualify as registered charities receive additional privileges, including the ability to issue tax deductible receipts to donors.

### **Charities**

Under the Canadian Constitution, the establishment, maintenance and management of charities fall within the jurisdiction of the provinces. In practice, however, it is the federal taxing authority – the CRA – which is the regulator of charities. The CRA's authority to regulate charities exists under the *Income Tax Act*, which confers significant advantages on registered charities, most notably tax exemption and the ability to issue official donation receipts.

To qualify for registration, a charity must: be resident in Canada, be established for charitable purposes, and devote its resources (funds, personnel, and property) to charitable activities. It should be noted that while the *Income Tax Act* sets out the rules related to charities, it does not define the term 'charitable'. The CRA therefore relies on the common law to determine whether or not an organization qualifies for registration. The common law test dictates that an organization seeking charitable registration must have purposes that fall within one or more of the following four categories:

- *relief of poverty* (food banks, soup kitchens, low-cost housing units)
- *advancement of education* (colleges, universities, research institutes)
- *advancement of religion* (places of worship, missionary organizations)
- *purposes beneficial to the community* (animal shelters, libraries, volunteer fire departments)

A charity must also meet the public benefit test. It must, in other words, demonstrate that its activities and purposes provide a tangible benefit to the public, that those benefits are either to the public as a whole or to a significant section of it, and that its activities are legal and not contrary to public policy.

<sup>6</sup> Stephen Faul, *Narrative Core Resource* (Toronto: Imagine Canada, 2014), available online at <http://sectorsource.ca/sites/default/files/resources/files/narrative-core-resource-en.pdf>.

<sup>7</sup> Michael H Hall et al. *The Canadian Non-profit and Voluntary Sector in Comparative Perspective*, 2005 at p.IV.

<sup>8</sup> *Ibid* at p.8.

Of the 180,000 organizations that comprise the NPO sector in Canada, approximately 86,000<sup>9</sup> are registered charities.

## Non-profit organizations

Under the *Income Tax Act*, non-profit organizations are defined as clubs, societies, or associations that are organized and operated exclusively for social welfare, civic improvement, pleasure or recreation, or any other purpose except profit.<sup>10</sup> The incomes earned by such organizations cannot be made available for the personal benefit of their members. Non-profit organizations generally include:

- *recreational or hobby groups (bridge clubs, curling clubs, golf clubs)*
- *political parties*
- *certain amateur sports organizations (hockey associations, baseball leagues, soccer leagues)*<sup>11</sup>
- *certain festival organizations (parades, seasonal celebrations)*

The estimated 94,000 non-profit organizations operating in Canada are not subject to a public benefit test. Unlike registered charities, the benefits conferred by such organizations may be restricted to particular groups, such as recreational clubs or professional associations with specific memberships. While NPOs do not need to apply for registration with the CRA to benefit from their tax-exempt status, they are, in practice, subject to various reporting requirements depending on their size and structure.<sup>12</sup>

It is important to note that organizations engaged in charitable works, whether registered or not, are excluded from qualifying as non-profit organizations under the *Income Tax Act*. This means that charities can only benefit from tax exemption if they obtain registered status from the CRA.

## OVERSIGHT

### Reporting Requirements

#### Registered Charities

All registered charities must file an annual information return with the CRA. Those that fail to file with the CRA may have their charitable registration revoked, thereby losing the privileges associated with registration. The annual return includes information on programs being carried out by the organization, details about its revenues and expenditures, as well as a copy of its financial statements. The majority of the information collected from charities is made publicly available online, or is available upon request from the CRA.

Registered charities must additionally comply with any regulatory measures imposed by the provinces in which they reside. As noted in the previous section of this document, in Canada, the responsibility for

<sup>9</sup> CRA, "Charities Program Update – 2015", available online at [http://www.cra-arc.gc.ca/chrts-gvng/chrts/bt/chrtsprgrm\\_pdt-2015-eng.html](http://www.cra-arc.gc.ca/chrts-gvng/chrts/bt/chrtsprgrm_pdt-2015-eng.html).

<sup>10</sup> *Income Tax Act RSC 1985*, (5th Supp.) c.l, paragraph 149(1)(l).

<sup>11</sup> It should be noted that Canadian amateur athletic associations that qualify as non-profit organizations and have the promotion of amateur athletics in Canada nation-wide as their exclusive purpose and function, are eligible for specific tax exemptions under the *Income Tax Act*. Registered Canadian amateur athletic associations (RCAAs), like registered charities, are tax-exempt and able to issue donation receipts to donors. They are also subject to extensive regulation by the CRA and must comply with filing requirements similar to those imposed on registered charities.

<sup>12</sup> This will be discussed in further detail in the "Reporting Requirements" section of the document.

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managing the operations of charities falls primarily to the provinces and territories. Some provinces, notably Ontario, have regulatory measures in place which require charities to register and report annually, as well as legislation which provides for various sanctions and remedies in the event that charities misuse or misappropriate charitable property. Other provinces, such as Alberta, have enacted various measures to regulate the fundraising activities of such organizations. Registered charities must comply with both provincial and federal legislations if they wish to retain their status.

### Non-Profit Organizations

The CRA also has the capacity to obtain timely information about the broader non-profit sector. All NPOs having assets in excess of \$200,000 CAD or annual investment income exceeding \$10,000 CAD must file an annual NPO Information Return with the CRA,<sup>13</sup> which includes information about their activities, assets and liabilities, and the amount of money received during the fiscal period in question. These NPOs must also indicate whether they carry out activities outside of Canada, as well as disclose the physical location of their books and records.

## **SELF-REGULATION**

Canada has a number of 'umbrella organizations' that provide guidance and varying degrees of oversight to the charities and non-profit organizations within the NPO sector.

An example of such an organization is Imagine Canada<sup>14</sup>, a national umbrella for Canada's charities and NPOs, which seeks to strengthen public confidence in the non-profit sector. As such, it offers accreditation to organizations through its "Standards Program". The "Standards Program" is a Canada-wide set of shared standards for charities and NPOs designed to demonstrate their compliance in the areas of board governance, financial accountability and transparency, fundraising, staff management, and volunteer involvement.<sup>15</sup> It helps organizations mitigate risk by ensuring that staff and volunteers understand and meet their legal, financial and fiduciary responsibilities, and provides donors with a sense of confidence in the sector.

Other umbrella groups, such as the Canadian Council of Christian Charities, offer similar certification programs which encourage accountability and transparency in the sector.<sup>16</sup> There are also behavioural standards such as Imagine Canada's *Ethical Code Program*<sup>17</sup> and the Association of Fundraising Professionals' *Code of Ethical Principles and Standards*<sup>18</sup>, which govern the conduct of charities and non-profit organizations.

## **FINDINGS OF THE FATF TYPOLOGIES REPORT**

The case studies analyzed for the FATF Typologies Report indicated that there was a correlation between the types of activities an NPO is engaged in, and the risk of abuse. The majority of the case studies dealt with NPOs engaged in 'service activities' (housing, social services, education, or health

<sup>13</sup> *Income Tax Act RSC 1985*, (5th Supp.) c.l, paragraph 149(12).

<sup>14</sup> Imagine Canada, "Charities and Non-Profits Meet High Standards", available online at <http://www.imaginecanada.ca/who-we-are/whats-new/news/charities-and-nonprofits-meet-high-standards>.

<sup>15</sup> Imagine Canada, "About the Standards Program", available online at <http://www.imaginecanada.ca/about-standards-program>.

<sup>16</sup> Canadian Council of Christian Charities, "Certification Program", available online at <https://www.cccc.org/certification>.

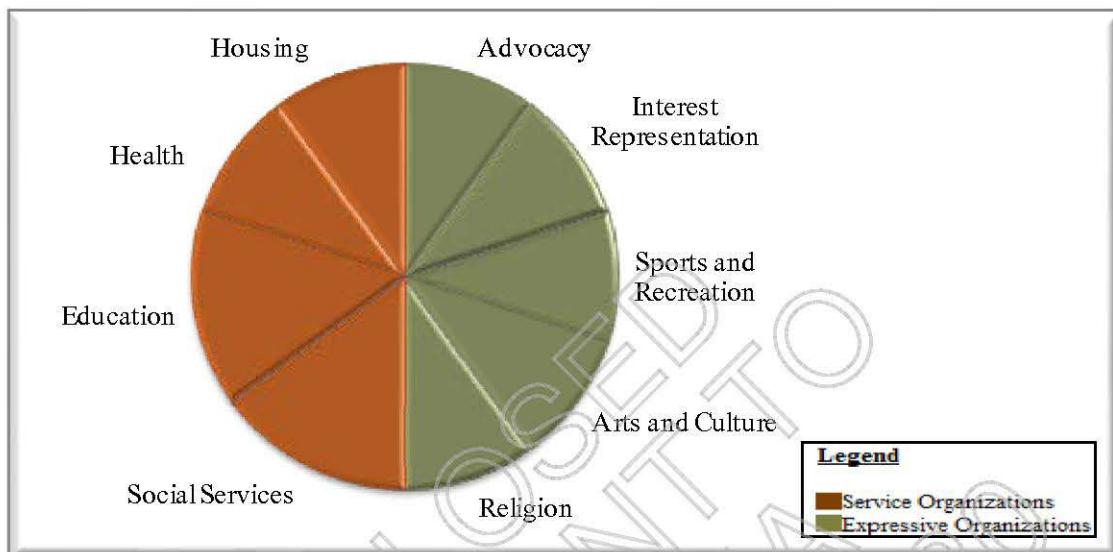
<sup>17</sup> Imagine Canada, "Ethical Code", available online at <http://www.imaginecanada.ca/our-programs/ethical-code>.

<sup>18</sup> Association of Fundraising Professionals, "Code of Ethical Standards", available online at <http://www.afpnet.org/Ethics/EnforcementDetail.cfm?ItemNumber=3261>.

care), and none dealt with those engaged in 'expressive activities' (sports and recreation, arts and culture, interest representation, or advocacy). This suggested that NPOs conducting 'service' activities were the organizations most at risk of terrorist abuse.<sup>19</sup>

In Canada, the broader NPO sector is composed of both expressive and service organizations (see Figure 1 below).

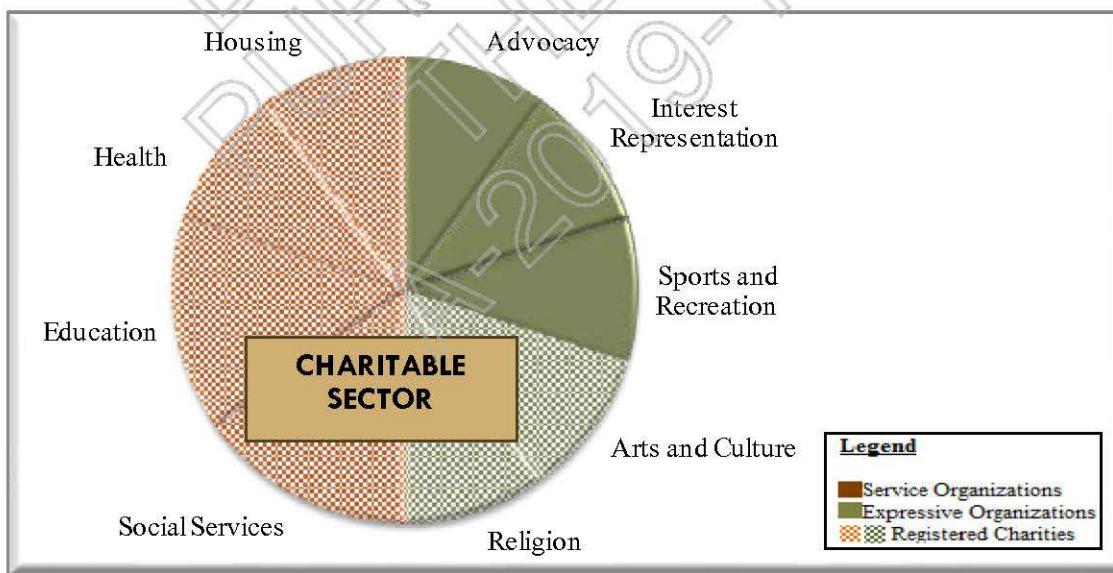
**Figure 1: Service and Expressive Organizations in the Canadian NPO Sector**



Note: This diagram is not to scale.

The studies consulted while preparing this sector review indicated that the charitable sector encompassed service organizations, as well as some expressive organizations<sup>20</sup> (see Figure 2 below).

**Figure 2: The Canadian Charitable Sector**



Note: This diagram is not to scale.

<sup>19</sup> FATF, *Risk of Terrorist Abuse in Non-Profit Organisations*, 2014, available online at <http://www.fatf-gafi.org/media/fatf/documents/reports/Risk-of-terrorist-abuse-in-non-profit-organisations.pdf>.

<sup>20</sup> Statistics Canada, *Cornerstones of Community: Highlights of the National Survey of Non-profit and Voluntary Organizations*, 2005 at p.15.

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According to CRA data from 2010, charities represent a significant portion of the financial resources of the overall NPO sector in Canada, accounting for 68% of all revenues in the sector and nearly 96% of all donations.<sup>21</sup> In addition, they account for a substantial share of the sector's foreign activities, as 75% of international not-for-profit organizations in Canada are registered charities.

In the course of conducting its national risk assessment, the CRA conducted an analysis of 30 Canadian case studies to determine whether the findings of the FATF Typologies Report held true domestically. The cases of abuse or risk observed by the CRA in the Canadian charitable sector generally corresponded to the findings of the FATF Typologies Report. In a sample of 30 cases where CRA identified abuse or substantial risk related to terrorism in the Canadian charity sector, all the charities involved fell under the 'service' classification.

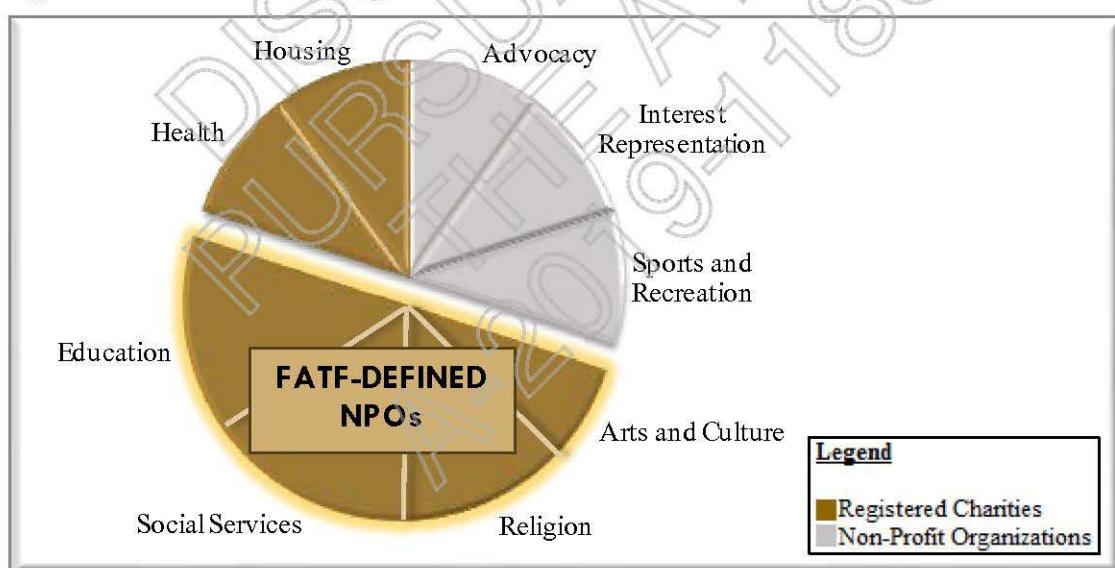
## FATF-DEFINED NPOs

The FATF's definition of NPO is a functional one, based on the activities and characteristics that put an organization at risk of terrorist abuse, rather than the simple fact that it is operating on a non-profit basis. As such, as stated by the FATF, Recommendation 8 does not apply to the entire universe of NPOs,<sup>22</sup> but only to those which fall within the following definition:

*A legal person or arrangement or organisation that primarily engages in raising or disbursing funds for purposes such as charitable, religious, cultural, educational, social or fraternal purposes, or for the carrying out of other types of "good works".*<sup>23</sup>

The activities conducted by service organizations, including education and social services, are consistent with those outlined in the FATF's functional definition of NPO. As indicated in the previous section of this document, the majority of organizations involved in such activities in Canada, are registered charities.<sup>24</sup>

**Figure 3: FATF-defined NPOs**



Note: This diagram is not to scale.

<sup>21</sup> This is in line with the FATF's functional definition of NPO which includes organizations "primarily engaged in raising funds".

<sup>22</sup> FATF, *Combatting the Abuse of Non-Profit Organisations*, 2015, available online at <http://www.fatf-gafi.org/media/fatf/documents/reports/BPP-combating-abuse-non-profit-organisations.pdf>.

<sup>23</sup> FATF, "Interpretive Note to Recommendation 8" in *The FATF Recommendations*, 2012.

<sup>24</sup> Statistics Canada, *Cornerstones of Community: Highlights of the National Survey of Non-profit and Voluntary Organizations*, 2005 at p.15.

A large portion of organizations in Canada – including charities focused on health and housing and NPOs engaged in activities such as advocacy, interest representation and sports and recreation – do not fall within the scope of the FATF definition of NPO (see Figure 3 above). This is due to the fact that the majority of these organizations either heavily rely on the government for funding<sup>25</sup>, or obtain the funds they need to conduct their activities through the sales of goods and services, membership fees, donations from households and corporate donations.<sup>26</sup> They are not, in other words, “primarily engaged in the raising or disbursing of funds”, and are therefore not inherently vulnerable to terrorist financing abuse. That said, it should be noted that the heavy reliance of some of these organizations on public funds means they are extensively regulated by the government, which maintains some authority to dissolve, amalgamate or prevent their dissolution.<sup>27</sup>

## CONCLUSION

The aim of Recommendation 8 is to address only those NPOs falling within the FATF definition (i.e., those primarily engaged in raising or disbursing funds for the carrying out of good works). Such NPOs are a subset of the broader NPO sector that, by virtue of the activities it undertakes, faces a greater risk.

One of the inherent challenges in assessing the risk of terrorist abuse in the sector is defining what constitutes a non-profit organization under Recommendation 8. This sector review establishes that in the Canadian context, registered charities are the organizations that fall within the FATF definition of NPO. Such organizations must be established and operated for charitable purposes, such as the relief of poverty, advancement of education, advancement of religion, or other purposes beneficial to the community. Registered charities are well positioned to raise and disburse funds for these purposes, due to their ability to issue donation receipts, and to receive and accept gifts and from other qualified donees<sup>28</sup>. Since they are required to abide by rules and regulations to maintain their status, registration further provides charities with credibility in the community, thereby increasing their appeal to potential donors.

It is important to note, however, that not all registered charities meet the FATF’s functional definition. As noted earlier in this document, while being registered as charities, service organizations such as those focused on health receive the majority of their financing from the government and have limited involvement in the ‘raising or disbursing’ of funds, a key component of the FATF’s definition of NPO. While they may not fall within the FATF definition, the CRA still regulates these and many other organizations, and has the ability to access the information it collects should the need ever arise. In other words, the CRA maintains detailed information on portion of the NPO sector that encompasses more than those organizations falling within the FATF definition of NPO.

Canada has reviewed existing studies and analyses of its NPO sector, and obtained a good understanding of the types of organizations operating within it. The cases of abuse or risk observed domestically supported the FATF Typologies Report’s finding that service organizations were the ones most at risk of terrorist financing abuse. As previously noted, service organizations, in Canada, are registered charities. Having identified this group as the subset of NPOs falling with the FATF definition,

<sup>25</sup> Statistics Canada, *Satellite Account of Non-profit Institutions and Volunteering*, 2007 at p.17.

<sup>26</sup> *Ibid* at p.19.

<sup>27</sup> Michael H Hall et al. The Canadian Non-profit and Voluntary Sector in Comparative Perspective at p.4.

<sup>28</sup> Under the *Income Tax Act*, “qualified donees” are organizations that can issue official donation receipts for gifts they receive from individuals and corporations. They include: registered charities, registered housing corporations resident in Canada constituted exclusively to provide low-cost housing for the aged, registered charitable organizations outside Canada to which Her Majesty in right of Canada has made a gift, and the United Nations, among others.

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Canada has been able to apply mitigating measures accordingly, and in so doing has been able to further protect its NPO sector from terrorist financing abuse.

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