

## **Canadian Bar Association's National Charity Law Symposium**

May 10, 2013

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Thank you for that kind introduction, Terry. I'd like to begin by saying how pleased I am to be here again at the National Charity Law Symposium. This event is unique in that it gives the CRA a chance to engage directly with the community of charity law practitioners. This is especially important and timely in light of the many changes introduced in the federal budgets of 2011 and 2012, and their ongoing implementation, specifically in regards to political activities.

I'd like to use my time today to update you on the CRA's progress on the budget items related to political activities and to express our hope that the CRA and the legal community can continue to work together as partners, to ensure that charities have all of the information they need to carry out their programs in full compliance with the law.

Before speaking to those issues, I'll begin with a few very brief comments on Budget 2013. Now, if I'm being perfectly honest, after two successive budgets with fairly substantive items for the Charities Directorate to manage, I was somewhat relieved to see that Budget 2013's impact on us was minimal!

Perhaps the most significant announcement was the introduction of a First-Time Donor's Super Credit. For first-time donors (and I would note that an individual will be considered a first-time donor if neither the individual nor the individual's spouse or common-law partner has claimed the Charitable Donation Tax Credit since 2007), the budget proposes to introduce a temporary supplement to the existing non-refundable tax credit for charitable donations by individuals. The new credit can be claimed once from the 2013 to 2017 taxation years.

This new credit effectively adds 25% to the rates used in the calculation of the Charitable Donation Tax Credit for up to \$1,000 of monetary donations. As a result, a first-time donor will be allowed a 40% federal credit for donations of \$200 or less, and a 54% federal credit for the portion of donations over \$200 but not exceeding \$1,000.

If you are interested in learning more about the new credit, I would encourage you to have a look at the information available on our Web site.

A final note on Budget 2013, many of you no doubt had also been following the House of Commons Finance Committee's review of the charitable tax incentive. The Government's response to the Committee Report was also outlined in the Budget and aside from the Super Credit, there was a commitment to work with the charitable sector to encourage more donations by a greater number of Canadians and further enhance public awareness, reduce red tape, and increase transparency and accountability in the charitable sector.

We at the CRA share these same objectives and will be doing our part to help advance and improve both the integrity and vitality of the charitable sector in the years ahead.

So with no new legislative provisions to implement as a result of Budget 2013, we are able to focus our attention on the agenda that was set out for us in the previous two federal budgets.

Those of you who attended last year's symposium will recall that I spoke at some length about the highlights of Budgets 2011 and 2012, and our plans to address the changes related to

registered charities. And, as you know, the changes from Budget 2012 were focused mainly on political activities.

In the Budget, the government recognized that charities make a valuable contribution to the development of public policy. However, a concern was also expressed that, to quote directly from the Budget, "some charities may not be respecting the rules regarding political activities". The Budget therefore introduced legislative measures, and steps for the CRA to take administratively, to address this concern.

More specifically, the Budget called for increased transparency and reporting obligations for charities, and provided funds for the CRA to carry out enhanced compliance and education activities. Our plan, as I explained last year, included revising Form T3010, the *Registered Charity Information Return*; developing practical self-assessment tools for charities; and carrying out more proactive monitoring of political activities. I don't think you'll be surprised to hear that this plan has occupied a significant amount of our time over the past several months.

One reasonable question that might be asked is what has been delivered as a result of the additional resources that were invested in the Charities program in support of this initiative? One media article from earlier this year highlighted the fact that out of last year's nearly 900 audits, only one charity was revoked because of its political activities. Besides the fact that this was the first year of implementation, looking at revocations for political activities as the measure of effectiveness fails to recognize what we see as the more important objective: building long-term sector capacity and awareness to better self-assess and voluntarily comply with the rules.

Which begs the question - what have we achieved? In a few short months, much has already been accomplished.

- For example, revising the annual information return for charities, always a very expensive proposition, will enhance the amount of available information relating to charities' political activities. As returns are submitted over the coming years, this increased reporting will provide us with data on how much charities spend, the kinds of political activities being carried out, and the types of resources being devoted to them.
- The funding we received has also allowed us to develop an extensive information package that uses plain language and examples to illustrate the CRA's policy positions on political activities. This is a resource we will continue to add to as we receive feedback from the charitable sector on questions that need to be addressed.
- We have also put in place a team within our Compliance Division to carry out audits that focus specifically on political activities. We expect these audits will provide another rich source of data on the nature of political activities being carried out by charities, the amount and types of resources being devoted to these political activities, and any pervasive trends in non-compliance.

All of these activities will continue to deliver benefits well beyond the spending window provided by the Budget.

But let me take this opportunity to report back in a bit more detail on our implementation to date of the measures announced in Budget 2012.

### **Compliance Activities**

Of all the activities funded over the past year, the CRA's compliance program of monitoring and auditing charities to ensure they comply with the requirements of the *Income Tax Act* are probably the ones that have received the most attention. Even though there have been no changes to the statutory limits relating to charities and political activities, or to the CRA's core policy positions, the issue of enforcing the limits on political activities remains a sensitive one.

In some cases, a charity may engage in a political activity because of a firmly held belief that a change in the law is required in order to improve the welfare of a certain vulnerable group. Reminders by the CRA of the parameters within which political activities may be undertaken can lead to arguments by the charity for the necessity of those political activities, or suggestions that the CRA's efforts are being driven by a desire to stifle legitimate debate on social issues.

Compliance activities are one of the CRA's key tools for ensuring charities operate within the requirements of the *Income Tax Act*. This includes monitoring and audits. At this point, let me state again that the Charities program is managed in a fair and impartial manner, without political direction as to which charities should or should not be subjected to review and audit. This is critical to our role as a credible and effective regulator of the charitable sector. CRA employees act with the utmost integrity and professionalism in carrying out their responsibilities to administer and apply the provisions of the *Income Tax Act* that relate to registered charities.

I said earlier that we have formed a new team within our Compliance Division to monitor and carry out audits that focus on charities' political activities. This team is planning to conduct audits focussed on political activities between 2012 and 2016. It is important to note that these audits will be in addition to our regular audit activities.

We have endeavoured to develop an audit selection process that is fair and consistent, and that will provide a diverse range of charities to review. For example, one of the criteria we take into account in order to select files for review is regional balance: that is, charities are being selected from across Canada.

Another of the selection criteria we take into account is balance between different segments of the charitable sector. Since organizations falling under all four heads of charity can engage in political activities, charities from all four heads are being selected for audit. As a result, selected organizations will represent a wide variety of activities and purposes.

After determining which charities we will audit, a number of actions can be taken depending on the facts of each particular situation. For example, we could carry out a full audit, where we examine all the activities of a charity, political and otherwise. Or, our Compliance team may undertake a focused audit, limiting the review to the political activities of the organization. However, this team's mandate will not be limited to audits. In some cases, after reviewing the lead information, we may decide not to do an audit at all. Instead, we may send the charity a reminder letter, explaining that a limited review of their operations revealed possible issues with respect to political activities and reminding the charity of the limits. If we find a T3010 reporting error, we will notify the charity of the problem so it can take steps to correct it. Or, we may take no action at all if that is the reasonable conclusion given the facts before us.

If the results of an audit show that a charity is not complying with the requirements of the *Income Tax Act*, the CRA generally prefers to follow an education first approach, when appropriate, by making sure the charity understands the rules and requirements regarding their political activities. Another option might be to propose a written compliance agreement be put in place, which the charity signs as part of a commitment to address the concerns within a certain timeframe. But, with all this in mind, revocation is always an option, particularly when there has been serious non-compliance with the *Income Tax Act*.

In addition to the resources for compliance activities, Budget 2012 created a new sanction for charities that do not comply with the requirements for political activities. This sanction allows the CRA to suspend a charity's status as a qualified donee, which means it cannot receive gifts from other charities or issue official donation receipts.

Our impression is that some articles in the media have presented this new sanction in a way that implies restrictions on charities' political activities are being tightened. But from my perspective, the sanction actually gives the CRA more flexibility when examining a charity's political activities. Previously, our compliance efforts might begin with administrative steps such as education, or compliance agreements, but the only legislative option that remained after these measures was revocation. Now we have another, intermediate, step available when applying compliance actions.

### **Educational Activities**

Although our compliance activities are a key tool in the CRA's regulation of political activities by registered charities, we are also committed to providing educational materials for charities that illustrate and explain the rules. And, much as our compliance activities include an educational component, our educational activities in turn help to promote compliance. To that end, we recently introduced a new section on our Web site devoted to explaining the rules around political activities.

As I explained last year, according to data from our Form T3010, *Registered Charity Information Returns*, the number of charities that have reported carrying out political activities is less than 500. That number seems low to us. This may be a perfect example of how compliance, in this case with reporting requirements, may increase as charities' understanding of what constitutes political activities increases. If political activities are under-reported because not all charities realize they are carrying them out, our hypothesis is that educating charities about political activities will result in a rise in the number of charities reporting political activities on their T3010s.

In our experience, political activities is a subject that tends to be poorly understood within the charitable sector. The CRA recognizes that the distinction between a charitable expenditure and an expenditure on political activities can be a very fine one in some circumstances. We have an important role to play in providing charities with information on the rules under which registered charities in Canada must operate.

It can be a challenge for charities to understand what constitutes a political activity in the first place. While our policy on political activities lays out a very specific definition of political activities, some reports and articles in the media refer to political activities more broadly, and often include any activity that might be called advocacy or lobbying. Without a clear understanding of the CRA's definition of a political activity, a charity will obviously have difficulty both in complying and reporting these activities accurately.

For example, our guidance refers to a 10% limit on the use of a charity's resources for political activities. While this isn't wrong and remains an easy reference point, we have found that in some instances it has taken the focus away from the more fundamental requirement that a charity devote substantially all of its resources to its charitable purposes and activities. We also appreciate that it can be difficult to calculate the percentage of resources used on political activities, especially when dealing with resources that are not easy to monetize. In light of that reality, we do not prescribe a particular method that must be used to track the use of resources. Instead, we explain that a charity must be able to show which resources are used, how they have been used, and for what activity. We also ask that a charity be reasonable and consistent with respect to the method used to calculate its expenditures on, or use of resources devoted to, political activities.

The educational package we have developed also includes a Question and Answer document that addresses more detailed scenarios related to political activities. This is an ever-green document that we plan to add to from time to time, providing us some flexibility to address questions and issues that might arise in the future. Within this document, we have included a call for more questions from the sector, so that we can continue to build this resource.

In addition, we are putting the final touches on a new political activities self-assessment tool. It will allow charities to quickly and easily decide whether their use of resources for political activities is appropriate, or whether it is likely to raise concerns with the CRA. The tool will be added to the new section on political activities on our Web site in the coming weeks.

Finally, we will also soon be releasing an updated webinar that walks charities through the fundamental requirements related to political activities. Accompanying this will be another new product, a short presentation we have developed that external third parties can use to deliver their own sessions on the basics of political activities for registered charities. We also plan to develop and release a number of short videos in the fall of this year.

## **Reporting Requirements**

Budget 2012 also called for increased transparency for registered charities, a measure that the CRA has addressed administratively through a revision of the T3010 Annual Information Return. During our review, it was important that we consult with sector representatives on both the T3010 and its accompanying guide. The feedback they provided allowed us to revise the return and its guide in a way that would make reporting easier for charities. Members of the bar were among those we consulted, and as always, we particularly appreciated their thoughtful input. The form has been finalized and is on our Web site, for use for fiscal periods ending on or after January 1, 2013.

You will also recall that one of the legislative amendments resulting from the budget concerned gifts to another qualified donee for the purpose of supporting the recipient's political activities – these gifts are now considered to be a political activity. The revised form T3010 requires a charity to specify what amount of gifts was given to other qualified donees as a political activity. Before this change to the law, we had generally characterized these transfers as ordinary gifts to qualified donees, and therefore charitable.

This new provision has sparked a number of interesting questions. For example, some concern has been expressed about double-counting. That is, since gifts to a qualified donee to support political activities are now a political activity for donor charities, and the gift will presumably be spent on political activities by the recipients, the same amount of money will be reported on both the donor and recipient charities' T3010s as an expenditure on political activities. One concern resulting from this is that the statistics on spending on political activities will be artificially inflated.

While it's true the gift could be reported twice as an expenditure, the T3010 also requires a charity to identify what amount of gifts were given to fund political activities. This should allow us to approximate the amount of political activities that were gifts to qualified donees. In any event, we also recognize that in many cases the amounts will not reconcile, as not all gifts are spent in the same fiscal period, spent as requested by the donor, or even spent at all.

As I discussed last year, we have expanded the number of questions on the core form regarding political activities, and added a new schedule that is specifically for a charity's political activities. Our guide to completing the T3010 was also amended to reflect these changes and now includes detailed guidance that includes examples, to help charities comply with new reporting requirements.

It will take some time to collect enough data from the T3010 to begin any kind of useful analysis. Since the new form is only in use for fiscal periods ending January 1, 2013 and forward, we will have to wait a year or two before enough of the registered charity population has filed returns, and we have collected enough data to begin reviewing the results.

Ideally, these new reporting requirements, along with our enhanced compliance and educational activities, will form an effective feedback loop. The results of our compliance efforts will help us understand what areas we need to focus our educational activities on, which in turn will assist charities in meeting their reporting requirements, and this improved data can then be fed back into our audit processes to refine our activities on that front. Although each activity is undertaken through different means, the ultimate purpose is, of course, to enhance compliance with the provisions of the *Income Tax Act*.

### **Final Thoughts**

But, with all this in mind, the fact remains that our tax system is one that relies on voluntary compliance. The CRA averages less than 800 charity audits per year, or a coverage rate of just under 1%. One of the implications of our limited number of reviews is that we must target our compliance activities in order to achieve maximum results. We simply do not have the capacity to investigate every charity, every year – nor would we want to. And the financial stakes are high, since charities are given significant tax privileges that even a small minority of organizations can abuse to huge effect, as we've seen from tax shelters and false receipting. While we continue to use random audits in order to get a sense of overall compliance levels, leads related to serious cases of non-compliance, including our own analysis of program data, remains a key tool.

Canada's system of taxation is based on self-assessment and while there are challenges and certain vulnerabilities, it is working well. One of the reasons it works in the context of registered charities is because the vast majority of charities want to follow the rules, including those relating to political activities. For those organizations that are not compliant, our intuition is that most problems arise from not entirely understanding the rules, or even being aware that there are rules, rather than acts of intentional non-compliance.

One of our goals over the past year has been to develop and promote the CRA's library of educational products, which we hope will naturally lead to increased rates of compliance as more charities come to understand the rules. Education can head off potential problems on a broader scale before they even occur – an ounce of prevention may be worth a pound of cure, in other words.

We trust this is an area where the CRA can ask for your support. Since in your own practices you may work directly with charities' representatives, you are in a perfect position to refer your clients to the CRA's educational resources. If this isn't already a regular practice, we would encourage you when possible to direct your clients to our educational resources – our Web pages, videos, and webinars – and invite them to register to our electronic mailing list – which is the best way to keep on top of what's new. We believe that an informed charity is more likely to be a compliant charity and that by working together we can help to protect the integrity of Canada's charitable registration system and promote public confidence and support for the charitable sector.

There no doubt will be more questions to answer as we move forward. We welcome your input and look forward to continued cooperation.

Thank you for your time, and I hope you enjoy the remainder of the symposium.