Peter Broder

Fundraising Cost Ratios

In early April, a column appeared in the *Vancouver Sun* lamenting, yet again, examples of exorbitant profits earned by for-profit fundraising companies contracted by charities to solicit donations on their behalf.

The figures cited are infuriating. For example, one charity reported proceeds of $1.45 million from fundraising with $1.22 million of that going to the fundraisers.

Such accounts doubtless have the effect of dissuading potential donors from giving to charities that strive to manage their fundraising programs carefully, as well as those that – whether deliberately, through neglect, or through incompetence – allow costs to mushroom out of all proportion to the amount collected for charitable work. Often, most upsetting for donors is not the costs themselves, but having been misled about the spending associated with the fundraising activity, or deceived about where the proceeds from the fundraising are going.

Jurisdiction over the fundraising activity of registered charities is shared by the federal and provincial governments. To qualify as a registered charity under the *Income Tax Act*, an organization must devote all of its resources to charitable work. This means that if its fundraising becomes an end in itself, rather than a means to an end, it risks losing its registration status. As well, the Canadian Constitution explicitly gives the provinces the authority to regulate the operation of charities and like groups.

The federal regulatory body, the Charities Directorate of the Canada Revenue Agency (CRA), has recently published guidelines setting out acceptable and unacceptable fundraising practice for registered charities. (Full disclosure: as part of an Interchange with CRA in 2007 and 2008, I worked on an earlier draft of those guidelines.)

The new CRA guidelines divides fundraising cost/revenue into several categories, but does not set out ratios that are always acceptable or always prohibited. Groups falling within a particular category may still be found to be offside or in compliance regardless of their cost ratio, depending on a variety of circumstances beyond their reported figures.

In addition, a number of provincial regulatory bodies, most prominently Alberta's Charitable Fund-raising Business Licence Office (which administers the province's *Charitable Fund-raising Act*), and Ontario's Office of the Public Guardian and Trustee (which administers that province's *Charities Accounting Act*), are directly or indirectly empowered to deal with fundraising or other aspects of charities' operations. Even where provinces have not established a regulatory body for charities, the Attorneys General have *parens patriae* jurisdiction to oversee them.

However, scarce enforcement resources and the overlapping jurisdictions tend to lead regulators, whether federal or provincial, to be cautious about asserting their authority and to take on only the most egregious cases. This leaves many situations, ranging

from the merely dubious to the highly abusive, unaddressed. The huge number of fundraising activities and transactions of charities mean that regulators are, at best, able to respond to a fraction of the issues brought to their attention.

Compounding other enforcement difficulties is the lack of any definitive research on fundraising costs, or benchmarks for unacceptable (or acceptable) cost ratios in either legislation or case law. Courts have ruled that fundraising activity carried on in support of a charitable purpose is charitable. They have also held that a charity's contract with a fundraising company can be voidable as contrary to the public interest if the contract leads to misrepresentation to the public as to the amount of money raised actually going to the charitable purpose.

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However, they have not pronounced on when fundraising costs are so high as to constitute a collateral purpose tainting the charity's exclusively charitable purposes, nor what percentage of fundraising proceeds a for-profit company can take before there is misrepresentation to the public.

As fundraising costs are highly variable and influenced by factors ranging from the size of the organization to the popularity of the cause to the method fundraising used, it is not surprising that a hard and fast standard has not been established.

Given these limitations, perhaps regulation is not the best option here. One recent development suggests an alternative.

CRA has been moving aggressively against a number of donation tax shelter schemes in recent months. These schemes typically involve gifting trust arrangements, leveraged cash donations, or buy-low/donate-high arrangements. They purport to allow the donor to receive a charitable tax credit far exceeding the cash outlay to make the donation. CRA has acted to shut down charities involved with schemes it considers illegal and has systematically re-assessed taxpayers claiming tax credits in connection with the schemes.

After CRA moved against the charity involved in one of these schemes and began re-assessing taxpayers who participated in the arrangement, a class action was launched by the donors against the scheme's promoters, the charity involved, and the professional advisers who gave a legal opinion on the arrangement. The action claimed breach of contract and negligence on the part of the parties that established and touted the arrangement.

Class action statutes typically allow for actions for negligent misrepresentation. This allows a potential remedy for donors taken in by an arrangement where proceeds from fundraising accrue to a for-profit fundraiser rather than to the ostensible beneficiaries of the donation. Such a self-help remedy would remove the need for donors having to rely on regulators to act on their behalf where they have been duped by a fundraising solicitation, and the charity's beneficiaries have been

deprived of the use of the charitable resources. (Whether such an action should be framed to recoup the diverted assets for the use of the beneficiaries or merely to allow the donors to recover their donations – subject to their claim for a tax credit being adjusted – is an open question).

Far more than current regulatory requirements, the availability of this type of action would compel charities, and those fundraising on their behalf, to be honest and forthright about the fundraising cost ratios. In addition, unlike the usual regulatory action, this approach would allow recovery of the diverted assets from the fundraising companies rather than just imposing an after-the-fact penalty on the charity – which does nothing to redress the loss suffered by the beneficiaries.

Lastly, it would generate a body of case law on what constitutes a reasonable cost/revenue ratio in fundraising and what constitutes due diligence on the part of a charity or someone fundraising on its behalf in disclosing fundraising costs to potential donors.

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