

Tax Policy, Charities and Democracy in Canada A Summary of the Problem and Remedy

Charities in Canada make significant contributions to the social and economic fabric of our country. The charitable sector contributes approximately \$90 billion per year to the Canadian economy. In 2000, Canadians gave 1.05 billion volunteer hours to charities and non-profit organizations.

The Problem

Canada's over 80,000 charities face limitations on their ability to speak out and participate in public policy debate and policy formulation in their fields of endeavour. These limitations - known as the 10% rule - are found in an administrative policy of the Canada Revenue Agency (CRA) which is based on poorly crafted provisions of the federal *Income Tax Act* (s. 149.1(6.1) & (6.2)).

The rule restricts charities to using no more than 10% of their resources on "political activities," which includes "communicating to the public that the law, policy or decision of any level of government in Canada or a foreign country should be retained, opposed, or changed" on matters that impact their charitable work and the communities and individuals they serve.

Charities are the only organizations in Canada that face limitations of this kind on their participation in the democratic process. This impediment adversely impacts their ability to advance their charitable causes, and weakens public policy debate and public policy development. This in turn ultimately weakens democracy in Canada.

Why it is a Problem

Rather than limit charities in this way, we should encourage them to participate in public policy debate for several principled reasons, including:

- Charities work to advance the public interest, not private interests;
- They are sources of problem-solving and innovation;
- They can give voices to marginalized Canadians;
- They foster civic engagement;
- Public opinion supports greater freedom for charities to speak out on their issues;
- Other jurisdictions provide greater latitude for their charities; and
- The limitations violate the value of freedom of expression.

Justifications for the Limitations

There are three arguments used to justify these limitations on charities: A) a tax policy argument; B) a fiscal impact argument; and C) a concern that charitable services will decline if the limitations are reduced.

A) The Tax Policy Justification

The primary justification for the current restrictions is a tax policy assertion of questionable merit. It is based on an alleged “general acceptance of the proposition that there should be limits on the degree to which one person can be required to subsidize the private political activity of another.” The reasoning goes this way:

- i. Donations to charities provide an income tax advantage or credit for donors.
- ii. The tax implications are that other taxpayers must pay more income tax (a subsidy) as a result of the credit given to donors to charities.
- iii. Such a subsidy is acceptable when charities deliver services, but must be restricted if charities speak on policy matters in their charitable fields.

The Failings of the Tax Policy Justification

a) Crude Design and Application

This justification for the 10% rule does not withstand serious scrutiny. Its fatal failing is that it does not recognize that the “tax expenditure” by the federal and provincial governments through charitable donation receipts amounts to just over 2% of the total revenue of Canada’s charities. The basic arithmetic is this:

- Canadians claimed donations of approximately \$5 billion in 2002.
- federal & provincial tax credits are worth 40% or \$2 billion (the “tax expenditure”)
- charities’ budgets total about \$90 billion annually. Most income is from service contracts won by charities.

\$2 billion is approximately 2.2% of the total budget of charities.

The 10% rule limits the use of all charity revenue, not just the small portion that may with some validity be called a “subsidy.” As a tax policy instrument, the 10% rule is extremely crude in design and application.

b) The Problem Entrenches Inefficiency

A second serious failing of this tax policy argument is that it does not take into account the fact that the 10% rule is a quota that entrenches inefficiency by preventing charities from publicly advocating efficient ways to solve problems. Providing valuable public policy input to help solve a problem may be far more efficient than merely treating symptoms of the problem.

c) Public Policy Input is not Private Political Activity

A third serious failing of the tax policy argument is the assertion that public policy input from charities amounts to “private political activity.” As discussed at greater length below, all charities are legally bound (and properly so) to advance the **public interest**, and cannot pursue private interests. To categorize the efforts of a health charity to have government establish higher workplace safety standards, for example, as “private political activities” misses a critical distinction between public and private interest, and misconstrues the nature of charity.

B) The Fiscal Impact Argument

A second argument used in defense of the 10% rule is that if it is removed or modified, there will be a large increase in donations for charitable advocacy that will, through the tax credit and “tax expenditure” described above, have serious negative implications for the bottom line of governments.

The Failings of the Fiscal Impact Argument

The problem with this argument is that there is no evidence to support it. It is difficult to predict how much more receiptable donation revenue will come to charities if the 10% rule is changed.

An analysis by the Canadian Centre for Philanthropy (CCP) of data from the 1997 *National Survey of Giving, Volunteering and Participating* shows that Canadians gave \$19 million to “civic and advocacy organizations.” If one assumes that none of this amount is now receiptable and that a change in the law would make the full amount receiptable, at an average tax credit of 27%, the incremental cost would be approximately \$5.1 million per year to the federal government and, at an average of 42% of the federal tax rate, approximately \$2.2 million per year collectively to all provincial governments, for a liberally-estimated total of \$7.3 million per year.

Even if the numbers turn out to be 10 times greater than these, the argument that greater latitude will cause serious fiscal problems is not well founded.

C) The Concern that Charitable Services Will Decline if the Limits are Reduced

This concern is based on the premise that if charities devote more of their resources to public policy input, they will have fewer resources to devote to the delivery of charitable services and that this will have negative consequences.

Response to this Concern

This concern fails to recognise that it is not efficient for charities to continually treat the symptoms of community problems such as poverty. It would be far more efficient and beneficial to communities for charities to contribute their experience and wisdom to tackling the root causes of problems. Providing public policy input is the way that charities can contribute to problem-solving. By helping to solve the problems, charities will reduce demand for the treatment of symptoms. An example would be efforts by a cancer charity to change smoking laws rather than simply treating cancer sufferers.

This concern also fails to recognize the capacity of the Boards of Directors of charities to make informed decisions about how to allocate their scarce resources most efficiently. The current limitations impede that judgement and encourage the unproductive micromanagement of the operations of charities by the regulator.

CRA Guideline Revisions Could Not Address the Problem

The CRA revised its administrative guidelines on this issue in September 2003. The new guidelines reduce confusion and provide additional latitude to charities, but the guidelines are constrained by the poorly drafted provisions of the *Income Tax Act*. Proper remedy of the problem requires modest legislative amendment. Two amendment options are attached.

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Amendments to the
FEDERAL *Income Tax Act*
to allow greater latitude for charities to provide public policy input

Section 149.1(6.2) of the federal *Income Tax Act* states:

Charitable Activities. For the purposes of the definition “charitable organization” in subsection (1), where an organization devotes substantially all of its resources to charitable activities carried on by it and

- (a) it devotes part of its resources to political activities,
- (b) those political activities are ancillary and incidental to its charitable activities, and
- (c) those political activities do not include the direct or indirect support of, or opposition

to, any political party or candidate for public office,
the organization shall be considered to be devoting that part of its resources to charitable activities carried on by it.

Option A:

Amend section 149.1(6.2) as follows:

Charitable activities. For the purposes of the definition “charitable organization” in subsection (1), where an organization ~~devotes substantially all of its resources to charitable activities carried on by it and~~

- a) ~~it~~ devotes part of its resources to political activities,
- b) those political activities are ancillary and incidental to its charitable activities, and
- c) those political activities do not include the direct or indirect support of, or opposition to, any political party or candidate for public office,

the organization shall be considered to be devoting that part of its resources to charitable activities carried on by it.

Option B:

Replace section 149.1(6.2) with the following clearer statement:

A charitable organization

- a) must not provide direct or indirect support of, or opposition to, any political party or candidate for public office,
- b) may participate in public policy debate and advocacy intended to advance its charitable purposes, if:
 - (i) there is a reasonable expectation that this activity will further the purposes of the charity to an extent justified by the resources devoted to it,
 - (ii) the views expressed by the charity are based on a well-founded and reasoned case, and expressed in a reasonable way, and
 - (iii) this activity does not become the charity’s dominant activity.