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CHARITABLE PURPOSE, ADVOCACY AND THE *INCOME TAX ACT*

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INTRODUCTION

Charities receive preferential treatment under the *Income Tax Act*(1) (ITA). Not only is the income of a charity exempt from taxation, but a charity can issue charitable receipts to donors, who are in turn allowed to deduct amounts from their personal income tax. Registered status is thought to convey legitimacy on the organization, because donors distinguish entities that are subject to regulatory oversight by the Canada Revenue Agency (CRA). Charities are distinct from non-profit organizations (NPOs). An NPO may seek an exemption from income tax under the ITA,(2) but lacks the power to issue tax-deductible receipts for donations.

The preferential tax treatment of a charity amounts to an indirect government subsidy, and the registered status of a charity is therefore tightly guarded. This paper attempts to explain the requirements for charitable status under the existing provisions of the ITA and the common law. It then examines whether the rules are still rational. Given the range of organizations performing valuable functions in Canadian society, is the traditional definition of a charity still relevant? As social needs change, should more organizations be given the advantages enjoyed by a registered charity, principally the ability to issue charitable receipts to donors?

COMMON LAW DEFINITION OF CHARITABLE PURPOSE

Section 149.1 of the ITA provides rules for the tax treatment of registered charities, but does not define a charity itself. In the absence of a statutory definition, Canadian courts have developed a number of common law tests to determine whether an organization should receive charitable status. Under the common law:

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(1) R.S.C. 1985, c. 1 (5th Supp.).

(2) *Ibid*., s. 149.1(l).

- the charity's purposes must be exclusively and legally charitable, and the resources of a charity must be devoted to charitable activities in furtherance of the charitable purpose; and
- the charity must be established for the benefit of the public or a sufficient segment of the public.(3)

The CRA uses the common law test for charitable purposes developed by the U.K. House of Lords in the decision of *Commissioners of Income Tax* v. *Pemsel*.(4) Under the *Pemsel* decision, the four purposes of charity are:

- the relief of poverty;
- the advancement of education;
- the advancement of religion; and
- other purposes beneficial to the community as a whole that the courts have identified as charitable.

While more traditional charities qualify under the first three headings, other organizations that consider themselves charitable must qualify under the "other purposes beneficial to the community" heading. In order to do so, the organization must have a charitable purpose that is within "the spirit and intendment" of the preamble to the *Charitable Uses Act, 1601*,(5) commonly referred to as the *Statute of Elizabeth*. The *Statute of Elizabeth* lists a number of charitable purposes in its preamble, and includes not only the charitable staples of providing relief to the elderly, sick and impoverished, but also charitable activities dedicated to such things as the "Mariages of poore Maides" and "Supportacion Ayde and Helpe of younge Tradesmen, Handiecraftesmen and persons decayed."

The common law has, in addition to limiting the permissible classes of charity, also tried to prevent charities from engaging in "political" activities. Courts in Canada have determined that organizations that engage in political activities do not come under the four heads of charity, including "other purposes beneficial to the community."(6) Judges have reasoned that

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(3) *McGovern* v. *A.G.* [1982] 3 All E.R. 439.

(4) [1891] A.C. 531 (H.L.).

(5) 43 Eliz. I, c. 4.

(6) For a more complete summary of the position of charities and political activities, see the CRA Policy Statement "Political Activities," Reference Number CPS-022, 2 September 2003, http://www.cra-arc.gc.ca/tax/charities/policy/cps/cps-022-e.html#P130_11819.

by engaging in political activity, the charity enters into a debate over a policy that may or may not be a public benefit, rather than working towards an accepted public benefit. Moreover, in order to assess the public benefit of advocacy on policy issues, a court would have to take sides in a political debate, in the process usurping Parliament's role.

Although the common law does not allow charities to engage in any political activities, the ITA has modified the common law to permit registered charities to engage in some degree of political discourse. Subsections 149.1(6.1) and (6.2) of the ITA clarify that registered charities may engage in limited political activities. The provisions state that a charity must devote "substantially all" of its resources to its charitable purpose, but can dedicate part of its resources to political activities, as long as those activities are ancillary and incidental to its charitable purpose. The words "substantially all" are defined by the CRA as more than 90%. There is a further requirement that the political activities cannot be partisan, and cannot directly or indirectly lend support to any political party or candidate for public office.

Under the present law a charity may, without restriction, provide information and briefs to government or elected officials in order to promote change to laws or policies.

An additional section of the ITA operates to constrain a registered charity from engaging in substantial political activities. Subsections 149.1(1) and (2) of the ITA contain definitions for a "disbursement quota" that applies to all charitable foundations and organizations. The disbursement quota rules require that charities spend a specified proportion of the donations for which they issue tax receipts (typically around 80%)[(7)] on charitable activities or gifts to other charities. Subsection 149.1(1.1)(*b*) of the ITA provides that, in determining whether a charity has met its annual disbursement quota, expenditure on political activities is not to be included in the total. A charity that dedicated a substantial portion of its annual charitable receipts (more than 20%) to issues that had political overtones could have trouble meeting its disbursement quota, depending on its financial position.

(7) The level of the disbursement quota can be reduced if the charity has received gifts from inheritance, or gifts held in trust.

THE *PEMSEL* CLASSIFICATION, SOCIAL AND POLITICAL ADVOCACY AND CHARITIES

A. Common Law Definition of Charities

The common law definition of a charity presents a preliminary obstacle to benevolent organizations that may otherwise deserve charitable status. The three *prima facie* charitable purposes encompass historical social priorities that do not necessarily reflect current needs. The protection of the environment is not *prima facie* recognized as a charitable purpose because environmentalism was in its infancy at the time *Pemsel* was decided. It is clear, however, that environmental organizations can provide tangible benefits to society. It is difficult, from a policy perspective, to see why an organization promoting literacy should automatically receive preferential status over an organization that promotes equality for women, or that lobbies for cleaner air.

The scope of the accepted purposes of charities is often narrowly defined, and encompasses engagement only in non-contentious societal problems carried out in conventional ways. Until recently, for example, the advancement of education was limited to formal classroom instruction, and did not include informal workshops, seminars, and other training for the purpose of finding employment.(8) The charitable category of the advancement of education often conflicts with rules against political advocacy: courts have ruled that the educational purposes of a charity do not include the provision of educational materials designed to persuade people not to have an abortion,(9) or not to use pornography.(10)

In other words, the law as it currently stands may encourage charitable resources to be committed to a narrow range of non-controversial endeavours. Moreover, the law does not promote innovation in the delivery of services within the three *prima facie* categories of charity. The litigation costs of fighting for a more expansive charitable mandate may discourage all but the most persistent organizations.

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(8) *Vancouver Society of Immigrant and Visible Minority Women* v. *Minister of National Revenue*, [1999] 2 C.T.C. 1.

(9) *Alliance for Life* v. *MNR*, [1999] 174 DLR (4th) 442 (FCA).

(10) *Positive Action Against Pornography* v. *Minister of National Revenue*, [1988] 1 C.T.C. 232 (FCA).

There remains the possibility, of course, that the organization can apply for charitable status under the fourth head of the *Pemsel* classification, that of "other purposes beneficial to the community." The common law has recognized the need for flexibility in the definition of a charity. In Canada, the Supreme Court has cited with approval Lord Wilberforce's dictum that "the law of charity is a moving subject,"(11) and has said that the *Statute of Elizabeth* should not be read literally but in the context of contemporary society. This has not prevented confusion, given the myriad of judicial rulings on charities. In Australia, where the law of charities mirrors Canada's, the 2001 report of the Inquiry into the Definition of Charities and Related Organisations stated that "whether a purpose is within the 'spirit and intendment' of the Preamble or is analogous to a charitable purpose is ambiguous and could lead to inconsistencies."(12)

Using a legal test that relies on the charity being within the "spirit and intendment" of the *Statute of Elizabeth* can lead to dubious legal hair-splitting. In the case of *Vancouver Regional FreeNet Assn.* v. *M.N.R.*,(13) for example, the organization wanted to provide free access to the Internet to the public, and sought charitable status under the ITA. The Federal Court of Appeal eventually determined that the organization could meet the definition of a charity, partially on the grounds that the preamble to the *Statute of Elizabeth* included "the repair of bridges, ports, causeways and highways," and the network, as an "information highway," was analogously a means of communication. Tenuous connections to the *Statute of Elizabeth* are often legally ingenious, but arguably should not form the basis for establishing charitable status.

The Supreme Court of Canada itself has recognized the problems inherent in continuing to rely on the common law definition of a charity, with Mr. Justice Iacobucci stating in one judgment:

> Considering that the law of charity in Canada continues to make reference to an English statute enacted almost 400 years ago, I find it not surprising that there have been numerous calls for its reform, both legislative and judicial.(14)

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(11) *Scottish Burial Reform and Cremation Society Ltd.* v. *Glasgow Corpn.*, [1968] A.C. 138 (H.L.).

(12) *Report of the Inquiry into the Definition of Charities and Related Organisations*, June 2001, http://www.cdi.gov.au/html/report.htm.

(13) [1996] 3 F.C. 880 (FCA).

(14) *Vancouver Society of Immigrant and Visible Minority Women*, para. 126.

B. Political and Social Advocacy

The debate over political advocacy and charitable purpose is perhaps in part attributable to the changing focus of charitable resources. Many charitable activities, such as the relief of poverty and the advancement of education, have been to a large extent subsumed by governments since the *Pemsel* case. Some charities will understandably want to address social problems that only the government has the power or resources to fix. An organization that spends its entire resources lobbying government to spend more on the relief of poverty, for example, may not be considered a charity – even though the organization may be able to do more to relieve poverty, through public advocacy, than a soup kitchen that offers relief directly to the poor.

The restrictions placed on charities engaged in political activities may also prevent otherwise deserving organizations from engaging in important public policy dialogues. During the same-sex marriage debate, for example, the Bishop of Calgary wrote an open letter that said he would consider excommunicating Prime Minister Paul Martin over his government's plan to legalize same-sex marriage. The CRA responded, stating that the Catholic Church's charitable status could be put in jeopardy if the Bishop continued to engage in partisan political activity.(15) The ITA was amended in 2005 by Bill C-38, to offer additional assurances that a charity would not be discriminated against for expressing its views on same-sex marriage; however, this amendment contains limitations.(16)

According to the letter of the law, the CRA's interpretation is understandable: the ITA forbids partisan political activity, and suggesting that a party leader's views are immoral could be seen as tacit partisan political support for his or her opponents. Critics, however, questioned why a religious figure could not have reservations about the morality of a political

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(15) "Ten questions for Paul Martin: Tax minister's visit calls for more answers," *Calgary Herald*, 27 September 2004, page A11; "Revenue agent threatened tax hit," *The Globe and Mail* [Toronto], 22 October 2004, p. A7; "Revenue Canada threatens Henry: 'Be quiet or lose charitable status' bishop was told," *Western Catholic Reporter*, 1 November 2004, http://www.wcr.ab.ca/news/2004/1101/ henry110104.shtml.

(16) Bill C-38, *An Act respecting certain aspects of legal capacity for marriage for civil purposes* (1st Sess., 38th Parl., 2004-2005), contained a clause that protects the right of a registered charity to engage in the same-sex marriage debate without fear of losing charitable status. Bill C-38 did not, however, change the requirement that the charity devote at least 90% of its charitable resources to its primary purpose, for example the advancement of its religion. Nor can a charity engage in partisan political debate on the same-sex marriage issue. The section simply gives an extra statutory assurance that debating the merits of same-sex marriage, if ancillary and incidental to the charity's primary purpose, will not lead to revocation of charitable status.

leader's beliefs without risking revocation of the organization's charitable status.(17) Religious views on morality will occasionally clash with legislated morality, as expressed, for example, through the *Criminal Code*. In such cases, a threat by the CRA to revoke charitable status could be seen in part as a move to shield government policy from unwanted criticism. The rule against political discourse also seems to fetter the values of freedom of expression and freedom of religion that are enshrined in the *Canadian Charter of Rights and Freedoms*, especially where charities are expected to fulfil a role as the "voice of conscience" in relation to the government of the day.

Existing policy at the very least creates uncertainty and confusion among charities that wish to engage in some form of public advocacy. The determination of whether a charity is engaging in political activities is made by the CRA on a case-by-case basis. As the Voluntary Sector Roundtable has pointed out in a report on charitable activity:

> Even where organizations feel that the guidelines set out by Revenue Canada [Information Circular 87-1] are fair and reasonable, there is widespread (though not unanimous) concern that the supposedly objective yardsticks are being applied in a subjective and sometimes arbitrary or discriminatory fashion. There are even suggestions that Revenue Canada is issuing directives and warnings to organizations (for example in the area where organizations are part of a public policy-making process) that directly conflict with its own guidelines.(18)

C. Possible Reforms of the Law

In the Supreme Court of Canada case of *Vancouver Society of Immigrant and Visible Minority Women*, the Court was encouraged to accept a new definition of charity that would rest solely on whether the organization was performing a public benefit:

> Such an approach, it is suggested, would respect the precedents developed in the jurisprudence, but not to the exclusion of finding new activities to be charitable. This new approach, which would be triggered only upon an organization's failing to meet the traditional requirements, would be to ask whether the organization is performing

(17) House of Commons, Edited Hansard, No. 024, 15 November 2004, 19:05.

(18) Frances K. Boyle, *"Charitable Activity" Under the Canadian Income Tax Act: Definition, Process and Problems*, Voluntary Sector Roundtable Publications, January 1997, http://www.vsr-trsb.net/publications-e.html.

> a "public benefit." There would be no fixed definition or categories of public benefit. Instead, the court would consider a series of questions in making the determination, including whether the activities of the organization are consistent with constitutional and Charter values, whether the activities complement the legislative goals enunciated by elected representatives, and whether they are of a type in respect of which government spending is typically allocated. It is further suggested that such factors as vagueness and uncertainty could negate a finding of charity, but that vagueness alone would not be an automatic bar to classification as charitable because "many activities that we consider charitable are by their very nature vague and uncertain."(19)

The Court deliberated the merits of the reasoning, but in the end declined to adopt the approach, stating that:

> For this Court suddenly to adopt a new and more expansive definition of charity, without warning, could have a substantial and serious effect on the taxation system. In my view, especially in light of the prominent role played by legislative priorities in the "new approach," this would be a change better effected by Parliament than by the courts.(20)

A series of reports and policy initiatives have proposed changes to the legal definition of charities, and the liberalization of rules governing political activities. Distinguished charity lawyer Arthur Drache called for statutory reform in order to bring the legal definition of a charity into line with contemporary Canadian values.(21) In 1999, the Panel on Accountability and Governance in the Voluntary Sector, chaired by the Honourable Ed Broadbent, released a report that recommended that the federal government, in collaboration with the provinces and the voluntary sector, create a task force to establish a democratically determined, legislated

(19) *Vancouver Society of Immigrant and Visible Minority Women*, para. 197.

(20) *Ibid*., para. 200.

(21) A. Drache, with K. Boyle, *Charities, Public Benefit and the Canadian Income Tax System: A Proposal for Reform*, Ottawa, 1998. Mr. Drache's proposals include, *inter alia*: a statutory definition of charity encompassing "public benefit organizations" and "umbrella public benefit organizations"; provision for the filing of an election to allow organizations within the scope of the revised definition to be treated as either non-profit organizations or charities; and a reformed appeals process that would simplify and reduce the cost of challenging a revocation or refusal to register.

definition of which organizations should be considered charitable.(22) Finally, the Volunteer Sector Initiative Secretariat, a working group funded by the Government of Canada to look at reforms in the charitable sector, released a report in 2002 entitled *Advocacy – The Sound of Citizen's Voices*, which found that the needs of today's charities do not fit with Elizabethan concepts of charity, and concluded that it would be necessary to broaden the scope of advocacy by charities.(23)

Other commentators have recommended the status quo, saying that it would be simpler to let the law of charities evolve through changes in the common law, as opposed to legislative reform.(24) As previously indicated, however, Canadian courts have made clear that, at best, they will be willing only to make incremental changes to the definition of charity. It is left to Parliament to make more comprehensive changes to the law.

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(22) Panel on Accountability and Governance in the Voluntary Sector, *Building on Strength: Improving Governance and Accountability in Canada's Voluntary Sector*, February 1999, http://www.vsr-trsb.net/pagvs/Building_on_Strength.htm#Executive%20Summary%20and%20Principal %20Recommendations.

(23) Voluntary Sector Initiative Secretariat, *Advocacy – The Sound of Citizen's Voices*, September 2002, http://www.secteur-benevole-et-communautaire.ca/eng/publications/2002/position_paper.cfm.

(24) In the 1990s, the Ontario Law Reform Commission (OLRC) conducted hearings into the legal definition of charity but concluded that reform could be "better effected through further case law development than through statutory reform"; see OLRC, *Report on the Law of Charities*, Toronto, 1996. A similar conclusion was reached by law professor Patrick Monahan, who supported the OLRC's position against statutory reform. Professor Monahan attributes problems with the current definition to the lack of development of case law in the area, and concludes that this lack has given the CRA the discretion to formulate the definition; see P. Monahan with E. Roth, *Federal Regulation of Charities*, York University, Toronto, 2000.