



THE CANADIAN
BAR ASSOCIATION
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Bill C-470
Income Tax Act amendments
(revocation of registration)

NATIONAL CHARITIES AND NOT-FOR-PROFIT LAW SECTION
CANADIAN BAR ASSOCIATION

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PREFACE

The Canadian Bar Association is a national association representing 37,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice.

This submission was prepared by the National Charities and Not-for-Profit Law Section of the Canadian Bar Association, with assistance from the Legislation and Law Reform Directorate at the National Office. The submission has been reviewed by the Legislation and Law Reform Committee and approved as a public statement of the National Charities and Not-for-Profit Law Section of the Canadian Bar Association.

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Bill C-470

Income Tax Act amendments (revocation of registration)

I. INTRODUCTION

The Canadian Bar Association is a national association representing 37,000 jurists, including lawyers, notaries, law teachers and students across Canada. The Association's primary objectives include improvement in the law and in the administration of justice. This submission was prepared by the National Charities and Not-for-Profit Law Section of the Canadian Bar Association (the CBA Section). Members of the Section include lawyers across Canada who advise or serve on the boards of charitable and non-profit organizations. The CBA Section welcomes the opportunity to comment on Bill C-470, *An Act to amend the Income Tax Act (revocation of registration)* (the "Bill").

II. SUMMARY

The CBA Section questions the need for the salary disclosure requirement and compensation cap for registered charities proposed in this Bill. The stated objectives of the Bill, namely transparency and avoidance of extravagant expenditures by registered charities, can be met by permitting the Charities Directorate to monitor the activities of registered charities, including compensation to executives or other employees, within the existing framework in the *Income Tax Act* and regulations. In particular section 149.1(14) of the *Income Tax Act* requires all registered charities to file an annual T3010B Registered Charity Information Return.¹

Under the proposed disclosure requirement, Canadian registered charities would be required to divulge "the name, job title and annual compensation of the five executives or employees with the highest compensation". The CBA Section believes that the disclosure is unnecessary and unhelpful in light of current disclosure requirements.

¹ The form is located at the CRA Website at <http://www.cra-arc.gc.ca/E/pbg/tf/t3010b/README.html>

The second aspect of the Bill, the salary cap, would add to the list of things that would enable the Minister of National Revenue to revoke the registration of a charity. The additional criteria (and therefore grounds for revocation) would occur if the registered charity “pays to a single executive or employee annual compensation exceeding \$250,000”. Safeguards are already in place to prevent payment of excessive compensation and this one-size-fits all approach will undermine the viability of the charitable sector.

As discussed more fully below, although the salary cap will not automatically result in revocation of registration, the CBA Section is concerned that the exercise of this discretion will be unpredictable. In operation, the cap will in fact be a “hard” rather than a “soft” cap, with few registered charities likely to take the risk that their registered status might be revoked.

The CBA Section recommends that the Bill be defeated.

III. CANADA’S CHARITABLE AND NOT-FOR-PROFIT SECTOR

Canada’s charity sector is large and diverse. There are over 160,000 not-for-profits in Canada of which approximately 85,300 are registered charities². These include hospitals, museums, universities, social service agencies, cultural organizations and many other organizations. While many registered charities are small, volunteer run and may not have any employees, at least 15 charities have annual revenue over \$1 billion and of them six have revenue over \$2 billion dollars.³ Many registered charities deal with some of the most complicated and intractable issues facing Canadian society.

IV. CONCERNS WITH BILL C-470

A. No Public Consultation

Bill C-470 was originally introduced as a Private Members Bill in October 2009. Most members of, stakeholders in, and advisers to, the charity sector only became aware of the Bill when The

² According to the CRA Charities Listing on August 26, 2010.

³ According to T3010 Registered Charity Information Return data for 2008.

Globe and Mail reported on it on March 16, 2010⁴. There was no public consultation or discussion with the charity sector about this proposed legislation, which could result in the loss of charitable status of some of Canada's largest charities.

B. Is Excessive Compensation a Problem in Canada?

In our view, excessive compensation paid by registered charities is not in fact a significant problem in Canada. To the contrary, a great deal of important work in the charitable sector is unpaid or underpaid. Most registered charities rely on volunteers or have under-paid staff. Approximately 54% of charities have total revenue under \$100,000⁵ and many do not have even one paid employee. The perception, based on statements in the House of Commons when the Bill was debated and by the member introducing the Bill, is that the charity sector may be out of control and that many charities line the pockets of their senior executives with excessive pay packages. The CBA Section sees no evidence to that effect aside from one or two specific instances mentioned in the media, which should not form the basis for a broad policy that will have negative repercussions. Executive compensation, while important, is only one factors that should be reviewed in determining whether a registered charity operates efficiently, provides adequate transparency to the public with respect to its operations and does not violate the trust placed in registered charities by donors, the public generally and the income tax system. Payment of compensation of \$250,000 does not necessarily imply excess, waste, misdirected resources or any other type of improper activity inconsistent with a registered charity that administers a significant budget devoting all of its resources to its own activities as required by the *Income Tax Act*.

C. Transparency

Transparency and accountability in the charity sector are desirable. However, transparency is not an absolute value and must be balanced with privacy, efficiency, and other factors. Disclosing the compensation range (but not the name of the person receiving it) for the ten highest-paid executives or employees provides a suitable level of transparency without violating the privacy of individuals.

⁴ See "Liberal pushes charity transparency bill" at <http://www.theglobeandmail.com/news/politics/ottawa-notebook/liberal-pushes-charity-transparency-bill/article1501959/> / Retrieved August 26, 2010.

⁵ CRA Report "Small and Rural Charities: Making a Difference for Canadians 2008", pg. 9. Retrieved July 22, 2010 <http://www.cra-arc.gc.ca/E/pub/tg/rc4457/rc4457-e.pdf>

Under the current version of T3010B, revised in 2009, registered charities are required to disclose for the ten highest compensated, permanent, full-time positions, the number of individuals falling within the following salary ranges:

- \$1 - \$39,999
- \$40,000 - \$79,999
- \$80,000 - \$119,999
- \$120,000 - \$159,999
- \$160,000 - \$199,999
- \$200,000 - \$249,999
- \$250,000 - \$299,999
- \$300,000 - \$349,999
- \$350,000 and over.

This information is publicly available at the CRA website at no charge.⁶ A registered charity that fails to disclose the required information is subject to sanctions, including the ultimate sanction of revocation of registration.

D. Privacy

Bill C-470 will require disclosure of the top five salaries. For many organizations this will mean disclosing the small salaries earned by many individuals. The CBA Section believes that it is an unnecessary and unwarranted invasion of privacy to disclose a person's salary, no matter how small, merely because that person works for a registered charity (which may receive no government money and may not even issue tax receipts).

There is no compelling reason from an income tax perspective, either based on transparency or accountability, to require the identification of individual employees. The CBA Section believes that the current disclosure in the T3010B is adequate and enables the public and the Charities Directorate to determine the extent of salaries paid in various ranges, even in excess of \$350,000, and identify the number of individuals receiving salaries at those levels.

E. One Size Fits All Compensation Limit

The second aspect of the Bill would cap total compensation paid by a registered charity to any executive or employee at \$250,000 per year irrespective of the size, complexity or type of charity. The Section believes this is harmful to the charitable sector. We are not aware of any other country with a compensation cap on its charitable sector.

⁶ The Charities Listing is at <http://www.cra-arc.gc.ca/chrts-gvng/lstngs/menu-eng.html>

F. Bill Would Undermine Innovation in Canada and Other Government Programs

There is competition globally for talent and a salary cap will put some larger Canadian charities at a significant disadvantage. Many of the largest registered charities in Canada, such as universities and hospitals, would face the uncertainty of possible deregistration if they pay their most senior executive or researcher or specialist or other employee compensation over \$250,000. If a Canadian charity, such as a hospital or research foundation or university convinces a top US researcher to work in Canada for \$300,000, it may be perfectly appropriate in the circumstance, especially if the person is important for the success of the program and was earning substantially more in the US. Some hospitals in small and rural communities have had trouble finding certain types of specialists to fill positions and sometimes have only had success when offering more competitive compensation than a comparable urban hospital. Such hospital's inability to pay more than a capped amount will put them at a serious disadvantage to Canadian urban hospitals and other hospitals around the world.

A large amount of effort and resources have been spent by Canadian federal and provincial governments to bring top talent to Canada, such as the Canada Excellence Research Chair (CERC)⁷ and this and other initiatives may be undermined by the salary cap.

G. Existing Mechanisms For Compliance Action

The CRA Charities Directorate already has tools at its disposal to deal with excessive compensation by charities. For instance, Section 188.1 of the *Income Tax Act* enables the Minister to impose sanctions where an undue benefit is conferred by a registered charity on a person. The undue benefit rule excludes an amount that is not reasonable remuneration for services rendered to the charity. Thus, the Minister currently has the ability to levy penalties against a registered charity that confers an undue benefit by paying remuneration that is not reasonable. In virtually all cases, if CRA alleges that excessive compensation has been paid by the charity, it will likely also allege that an undue benefit has been conferred or the charity is otherwise not in compliance. Adding provisions to the *Income Tax Act* aimed at increased accountability and transparency, at the cost of additional uncertainty, is not well advised in the opinion of the CBA Section.

⁷ <http://www.cerc.gc.ca/hp-pa-eng.shtml>

Generally, CRA takes an “education first” approach to compliance issues⁸. CRA works with non-compliant charities to bring them into compliance. Only in egregious or extreme cases does it proceed to revoke charitable status. Before contemplating revocation, CRA can currently impose intermediate sanctions such as monetary penalties. In Bill C-470, the sole penalty for non-compliance with the salary cap is revocation of charitable status. The CBA Section believes this is draconian.

H. Discretion Versus Cap

It will be of little comfort to charities and their boards that the Minister may not see payments over \$250,000 as a ground for revocation, since there will be a chilling effect. The summary with the Bill states quite categorically “This enactment amends the *Income Tax Act* to revoke the registration of a charitable organization, public foundation or private foundation if the annual compensation it pays to any single executive or employee exceeds \$250,000.”⁹ Despite CRA’s ability to exercise discretion, in most cases the \$250,000 limit will be a “hard” cap, and a registered charity exceeding it will do so at its peril, and run the risk that it will not convince the Minister not to exercise discretion to revoke registration. This will lead to a significant amount of uncertainty and will undermine the work of many large registered charities, by reducing the pool from which they can to draw senior staff.

I. Bill Creates Problem with Existing Employment Relationships or Contracts

Some registered charities currently have employees whose compensation exceeds the \$250,000 limit. A charity should not be forced to choose between losing its registered status and breaching its contracts with employees. For instance, if a registered charity has a five-year agreement with a researcher to pay \$300,000 per year, would the charity have to make a \$2 million payout to terminate the contract? Some registered charities may terminate existing contracts, pay out substantial termination and severance pay in 2010, and then hire the same person for compensation within the \$250,000 cap. The costs of terminating may be greater than continuing the employment. At the lower compensation level there is a greater chance that the executive or employee would move out of the Canadian registered charity sector.

⁸ See *Auditing Charities* T4118(E) <http://www.cra-arc.gc.ca/E/pub/tg/t4118/t4118-08e.pdf> Retrieved August 26, 2010

⁹ <http://www2.parl.gc.ca/HousePublications/Publication.aspx?DocId=4330149&Language=e&Mode=1&File=19> Retrieved July 22, 2010

J. Over Time Effect of Cap Could Become More Problematic

The cap would be enshrined in the *Income Tax Act* with no mechanism for an increase in the \$250,000 limit. With inflation, charities would have less purchasing power and the problem of attracting certain scarce talent would get progressively worse.

K. Bill discriminates unfairly against registered charities

Bill C-470 provides an unfair competitive advantage to private sector corporations and not-for-profits that do not have registered charity status and foreign charities, which could pay more to attract certain scarce talent. In addition, the Bill may encourage some charities to convert themselves or some of their assets into for-profit entities (particularly in sectors like seniors care where charities and for-profits are both active). While these transactions may be appropriate in limited circumstances, this practice is not to be encouraged.

L. Bill Encourages Inefficiency

Having a hard cap of \$250,000 may encourage strategies to avoid such a cap. For example, a foundation could pay half the salary and the operating charity could contribute another half or the charity could pay compensation of \$250,000 and local businesses could have a fund to contribute amounts above that. The proposed cap also could lead to individuals working part-time for more than one organization or to an organization hiring more than one person to fulfill one role. Various obvious attempts to circumvent the cap could lead to inefficiencies and ultimately cost the organization more.

M. Bill May Increase Senior Level Compensation

Presumably, proponents of detailed salary disclosure want to see higher end salaries reduced. Bill C-470 and similar proposals aimed at salary disclosure may actually have the opposite effect, namely fuelling increased salary expectation and competition amongst higher paid charity executives. The current requirement of disclosing annual compensation ranges provides CRA with information on who may need to be audited and information to a donor who wants to know salary ranges. Disclosing the top five employees' names and exact amount of compensation, may assist a few donors or journalists to form a view about an organization but the primary users of the information will be charity employees, executives and compensation consultants. These numbers could (and may) be used by senior executives and their consultants to argue that they should be paid more. For instance, an executive paid

between \$150,000 - \$200,000 by a charity may use this information to negotiate for higher compensation to match that paid by another charity. This could have an inflationary result with salaries below the \$250,000 cap.

The cap may send a signal that compensation up to and including \$250,000 is acceptable and that senior executives at charities should therefore be earning in that range regardless of the circumstances. This would not achieve the stated purpose of the Bill.

N. Problems with Definition of Compensation, Executive and Employee

Bill C-470 defines “compensation” to include salaries, wages, commissions, bonuses, fees and honoraria, plus the value of taxable and non-taxable benefits. This expansive definition imposes an obligation on charities of all sizes to determine the value of some elements of their compensation that may be difficult or costly to determine. While the compensation presumably must be determined in order to report remuneration paid to employees for payroll purposes, this new calculation will likely lead to increased compliance costs for many charities for which there is no suggestion that more transparency or accountability is required. It is also not clear whether payments, such as severance or retiring allowances, paid on the termination of employment would be regarded as compensation for this purpose.

The Bill’s reference to “executive or employee” could include independent contractors. It is not clear who is considered an “executive” under the Bill. Is any officer an “executive”? If a person is not an officer can they be an “executive”? The Bill does not define the term “executive” and neither does the *Income Tax Act*. It may be difficult for charities to determine whether some independent contractors are “executives”.

V. CONCLUSION AND RECOMMENDATION

Adding requirements for disclosure based on identification of individuals, and discretionary revocation of registration based solely on compensation paid to one person exceeding an arbitrary level are misdirected. The CBA Section does not believe that Bill C-470 will assist in achieving its stated objects. The CBA Section therefore recommends that the Bill not be enacted.