

2013 NATIONAL CHARITY LAW SYMPOSIUM

**AN OVERVIEW OF CRA'S
COMMUNITY ECONOMIC DEVELOPMENT GUIDANCE,
INCLUDING PROGRAM RELATED INVESTMENTS**

May 10, 2013

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A. INTRODUCTION

On July 26, 2012, Canada Revenue Agency (CRA) released Guidance CG-014, *Community Economic Development Activities and Charitable Registration* (the Guidance).¹ The Guidance replaces Guide RC4143, *Registered Charities: Community Economic Development Programs*, which had been available since December 23, 1999 (Former Guidance). The Former Guidance originated from a conference organized by the Muttart Foundation in October 1997. The Former Guidance states that community economic development (CED) is an evolving field, which it is. After fourteen years, this policy has now finally been updated.

The Guidance now gives charities more flexibility in conducting innovative programs aimed at improving economic opportunities and social conditions. It provides parameters in which registered charities may conduct CED activities that “improv[e] economic opportunities and social conditions of an identified community.” The Guidance is a welcome improvement over the Former Guidance, expanding the types of CED activities that charities may engage in, especially in the area of program-related investments. This paper reviews key features of the Guidance, noting the restraints placed on various forms of CED activities identified in the Guidance, and how the new guidelines differ from the guidelines contained in the Former Guidance.

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¹ Canada Revenue Agency, Guidance CG-014, *Community Economic Development Activities and Charitable Registration*, July 26, 2012 (online: <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/cmtycnmcdvpmt-eng.html>).

B. CED ACTIVITIES AND SOCIAL ENTERPRISE

The Guidance does not provide a definition of what CED means. Instead, it states that CED activities refer to a “wide variety of activities”. In describing what these activities are, CRA provides guidance from two perspectives.

Firstly, the Guidance points out two characteristics that are common to “many” CED activities. Instead of defining what CED means, the Guidance points out that, in general, “many” CED activities involve improving economic opportunities and social conditions of an identified community. In this regard, CRA accepts that a community can be defined in two different manners: (1) geographically; or (2) an identified group of eligible beneficiaries who share a common characteristic that results in an economic disadvantage. The Guidance indicates that it is also possible for a community to involve both factors (such as an identified group of eligible beneficiaries in a particular geographical area).² This is a welcome change from CRA’s previous narrow position in the Former Guidance, which states that “community” only refers to “the people living in a specific locality,” not to “a body of people having a religion, a profession, etc. in common” except persons with physical, mental, or developmental disabilities.

Secondly, the Guidance clarifies that “community capacity building”, “social enterprise”, and “social finance” activities may not necessarily be CED activities for purposes of the Guidance. CRA recognizes that these terms are often used to refer to activities that are “similar” to CED activities. However, CRA does not have official definitions for these terms and CRA recognizes that there are no universally accepted definitions either.³ Nevertheless, definitions for these terms are contained in Appendix A to the Guidance only for reference purposes for readers interested in considering these concepts further. Furthermore, CRA made it clear that these terms will not be used as determining factors in CRA’s registration and auditing processes. The Guidance states that regardless of how an activity is labelled, it will only be charitable if it directly furthers a charitable purpose.⁴

Over the past two decades, there has been a rapid global development in the area of social enterprise. As a result, various governments have taken steps in enacting legislation to encourage the continued

² *Ibid.*, para. 9.

³ *Ibid.*, para. 7 and Appendix A.

⁴ *Ibid.*, para. 8.

development of social enterprise, such as community interest companies (also referred to as CICs) in the United Kingdom and low-profit limited liability companies (also referred to as L3Cs) in the United States. In Canada, there has also been an increasing interest in engaging in social enterprise. However, there has been a lack of coordinated focus on the legal and organizational infrastructure to facilitate social enterprise in Canada, except the creation of hybrid corporate forms in British Columbia and Nova Scotia.

On May 15, 2012, the British Columbia's Bill 23, *Finance Statutes Amendment Act, 2012*,⁵ received Royal Assent. The Act amends, among other things, the B.C. *Business Corporations Act*⁶ to provide for a new corporate form of community contribution companies (3Cs). Regulations have been passed and will take effect on July 29, 2013.⁷ 3Cs are a hybrid vehicle intended to promote social enterprise. Requirements are in place to ensure that 3Cs primarily benefit the community, including restrictions on corporate reorganizations to avoid the circumvention of payout restrictions and an asset lock that caps dividends on company shares to ensure that profits are retained by the company or directed to the community benefit. These companies are subject to a higher degree of accountability than an ordinary company and are required to publish an annual report detailing their social spending.

On December 6, 2012, Nova Scotia's *Community Interest Companies Act*, Bill 153 received Royal Assent, allowing businesses to seek designation as a community interest company (CICs).⁸ This legislation is also aimed at supporting social entrepreneurship initiatives. To qualify for the CIC designation, a company must have a "community purpose," which the Act defines as a purpose beneficial to society at large, or a segment of society that is broader than the group of persons who are related to the community interest company. CICs are restricted in their ability to pay dividends and distribute assets on dissolution or otherwise and they must file a community interest report each year.

⁵ 4th Session, 39th Parliament, 2012, c.12.

⁶ SBC 2002, c.57.

⁷ B.C. Reg. 71/2013 (online:

<http://www.courthouselibrary.ca/training/BCProclamations/BCProclamationsItem.aspx?Id=02d056d6-9c2e-4536-ae5d-85c1df5ed90f>.

⁸ 4th Session, 61st General Assembly, 2012, c.38.

However, the *Income Tax Act (Canada)*⁹ has not been amended to provide corresponding tax relief to these hybrid forms of corporate vehicle. As a result, these hybrid corporations will continue to operate within existing framework in the Act, such as operating as for-profit entities, tax-exempt non-profit organizations, registered charities, and various combinations and structures utilizing these vehicles. For example, CRA recently expressed its view in a technical interpretation that because a British Columbia 3Cs is organized to provide profit to investors and social benefits, it will not qualify as a non-profit organization under paragraph 149(1)(l) of the *Income Tax Act* and it will be subject to tax as a regular corporation. CRA further expressed that if a non-profit organization incorporates a 3Cs and holds the shares of a taxable 3Cs subsidiary, this will not, in itself, cause the organization to lose its exemption under paragraph 149(1)(l) of the Act.¹⁰

As such, there are a few issues that the charitable sector and practitioners will need to note: (a) The mere fact that an activity is for a social good and is referred to as a social enterprise or social finance, or benefits community capacity building, does not necessarily mean that the activity is charitable. (b) These definitions must be reviewed in light of the circumstances involved in each activity and therefore they are not definitive parameters when determining whether an activity is charitable. (c) Since CRA recognizes that these definitions are for reference purposes only and are not determinative criteria to be applied by CRA on an audit, a lack of clarity of what CED means may make it difficult for charities to determine what activities would or would not be acceptable to CRA.

C. BASIS AT LAW FOR CED ACTIVITIES

The Guidance points out that the law in Canada does not recognize CED in and of itself to be a charitable purpose. Whether or not a CED activity is charitable will depend on whether it meets three factors: namely it furthers a charitable purpose, it benefits eligible beneficiaries, and meets the public benefits test.

First, in order to be considered “charitable”, CED activities must directly further a charitable purpose.¹¹ In this regard, the Guidance states that CED activities may potentially further the following heads of charitable purposes, namely relief of poverty, advancement of education and

⁹ R.S.C. 1985, c. 1 (5th Supp.), as amended.

¹⁰ CRA document number 2012-0456071E5, January 18, 2013.

¹¹ *Supra* note 1, paras. 6 and 8.

benefit the community in other ways the law regards as charitable.¹² By implication, it would mean that a CED activity cannot be conducted for the advancement of religion.

However, there is no reason why CED activities cannot further advancement of religion, such as micro loans for the poor as a practical manifestation of one's faith. Nevertheless, as a result of the current requirements of the Guidance, religious charities that want to engage in social programs would need to carefully review whether those programs are within the parameters of practical manifestation of their faith or whether the programs are within the ambit of CED activities as explained in the Guidance. In the latter scenario, it would be important for religious charities to understand that if they want to engage in CED activities, those activities must be conducted to further one of the other three heads of charitable purposes. This would in turn mean that those religious charities may need to carefully review the objects/purposes in their governing documents to determine whether they have the necessary objects/purposes to engage in CED activities. As well, because these activities are not conducted for the purpose of advancing religion, this may also affect how these activities may be conducted by religious organizations. For example, would a religious organization be able to include religious components in a CED activity that relieves poverty, such as a program that relieves unemployment?

Second, the Guidance states that each charitable purpose has specific requirements in relation to "eligible beneficiaries". To illustrate what this means, helpful examples were given in the Guidance: for a purpose that relieves poverty, eligible beneficiaries must be poor; for a purpose that relieves conditions associated with disability, eligible beneficiaries are individuals with conditions associated with the disability; for a purpose that relieves unemployment, the beneficiaries must be unemployed or facing a real prospect of imminent unemployment and be shown to need assistance.¹³

Third, to be charitable, the Guidance states that CED activities must meet the public benefit test as set out in CRA's policy on public benefit.¹⁴ In particular, the Guidance emphasized that in order to meet the public benefits test, the activity must not provide any private benefit that is more than incidental. This means any private benefit must be necessary, reasonable, and not disproportionate to

¹² *Ibid.*, para. 11.

¹³ *Ibid.*, para. 12.

¹⁴ CRA, CPS-024, *Guidelines for Registering a Charity: Meeting the Public Benefit Test Policy Statement*, March 10, 2006 (online: <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cps/cps-024-eng.html>).

the public benefit.¹⁵ A full review of the requirements of the public benefits test is outside the scope of this paper.

D. NOT RELATED BUSINESS ACTIVITIES

One key concept that has not been clarified in the Guidance but is implicit is that CED activities are “charitable” activities, not related business activities. This is referred to in two limited contexts in the Guidance. Specifically, the Guidance provides that a social business for individuals with disabilities must focus on helping eligible beneficiaries (*i.e.*, persons with disabilities) and not on making a profit.¹⁶ The Guidance also provides that employment-related training activities that do not meet the requirements in the Guidance are unrelated businesses, which are not permitted to be conducted by charities.¹⁷

As such, CED activities are not activities that are conducted for the purpose of providing an income stream, but are activities conducted to benefit beneficiaries that are charitable at law. Therefore, the requirements on related business activities of charities are not directly relevant to a discussion of CED as it does not constitute a business activity, whether it be related or unrelated.¹⁸

E. AREAS OF CED ACTIVITIES

The Guidance states that CED activities “generally” fall into the following five categories: activities that relieve unemployment; grants and loans; program-related investments; social businesses for individuals with disabilities; and community land trusts.¹⁹ This means that it is possible for a CED activity to fall outside these enumerated areas, although this is not specifically stated in the Guidance.

As well, the Guidance states that CED activities can be charitable when they promote commerce or industry as a whole for the public benefit, and not for advancing the interests of members of a particular industry.²⁰ The Guidance also sets out parameters for CED activities that improve socio-

¹⁵ *Supra* note 1, para. 10.

¹⁶ *Ibid.*, para. 74.

¹⁷ *Ibid.*, para. 23.

¹⁸ These requirements are explained in CRA’s Policy Statement CPS-019, *What is a Related Business?* March 31, 2003 (online: <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cps/cps-019-eng.html>).

¹⁹ *Supra* note 1, para. 14.

²⁰ *Ibid.*, para. 77.

economic conditions for the public benefit in an area of social and economic deprivation.²¹ A commentary on each of these areas is set out below.

1. Activities that Relieve Unemployment

In comparison with the Former Guidance, the Guidance provides a much more streamlined and succinct set of guidelines on CED activities that relieve unemployment.

Neither “providing employment” nor “helping people find employment” are charitable activities if the beneficiary group is the general public according to the Guidance.²² Activities that relieve unemployment or underemployment are only charitable if they directly further one or more of the three recognized charitable purposes (but not advancement of religion) as explained above.²³ For example, providing career counseling to people who are unemployed and living in poverty is a charitable purpose; but providing career counselling to the general public is not.

In addition, CED activities that relieve unemployment can be charitable only if the beneficiary group consists exclusively of individuals who are unemployed or facing a real prospect of imminent unemployment and are shown to need assistance (*i.e.*, unemployed persons who do not have the resources or skills to help themselves).²⁴ In other words, the beneficiary group must contain exclusively persons who are eligible beneficiaries, and cannot potentially include those who are not.²⁵ This general guideline is much more helpful than the confusing requirements set out in the Former Guidance on who charities may help in relieving and preventing unemployment, distinguishing between who first head charities can help as opposed to fourth head charities, requiring first head charities to help hard-to-employ individuals who meet a list of nine criteria²⁶ or helping other groups of individuals where exclusively all of the members in the group are below the poverty line.

²¹ *Ibid.*, para. 84.

²² *Ibid.*, para. 13.

²³ *Ibid.*, paras. 17 and 19.

²⁴ *Ibid.*, paras. 11, 13 and 17 and footnote 2.

²⁵ *Ibid.*, para. 12 and footnote 3.

²⁶ Including have been out of the labour force for over a year; have completed high school or post-secondary education and not found employment within a year; have not completed high school; are over age 45; or have a previous criminal conviction; etc.

In order to pass the public benefit test, care must be taken to ensure that private benefits that are more than incidental are provided to others. For example, it is not charitable if the emphasis is on helping employers recruit employees rather than helping beneficiaries find employment.

A list of helpful examples of CED activities that relieve unemployment is set out in the Guidance, such as providing career counselling or referral services to appropriate agencies for assistance, forming and facilitating mutual support groups for individuals seeking employment, providing assistance with résumés or preparing for job interviews, etc.²⁷ The listing of examples is a welcome change in comparison to the approach in the Former Guidance which provided an exhaustive list of relief of unemployment programs that were recognized by CRA to be charitable. As well, all of the programs listed in the Former Guidance are included in the list of examples in the new Guidance, implying that charities can now conduct programs that meet the requirements in the new Guidance that they were not able to under the Former Guidance.

The Guidance also provides detailed guidelines in relation to one of the examples listed in the Guidance, *i.e.*, employment-related training program. In general, employment-related training, such as computer skills instruction, must not be limited to specific employers because this could offer an unacceptable private benefit to the employer. Exceptions are available for employment programs conducted in areas of “social economic deprivation” (see further commentary below).²⁸

Examples of employment-related training include (1) employability training: developing the skills necessary to prepare for employment (such as English or French as a second language), as well as life skills (such as time management and interpersonal relations); (2) entrepreneurial training: providing instruction on preparing a business plan, obtaining financing, bookkeeping, preparing financial statements, marketing, and government regulations; and (3) on-the-job training: providing on-the-job training in vocational or work skills that enhance an individual’s employability.²⁹ The description and requirements for all three types of programs are generally the same as the Former Guidance with the exception that the Former Guidance recognizes training programs to help employees of a particular company can be charitable involving first head charities helping hard-to-employ individuals.

²⁷ *Supra* note 1, para. 18.

²⁸ *Ibid.*, para. 21.

²⁹ *Ibid.*, para. 22.

The Guidance states that the focus of the third type of activity (on-the-job training programs) must be providing training to the eligible beneficiaries employed by the charity, not jobs. This type of activity is referred to as “training businesses” in the Former Guidance. The Guidance sets out a number of characteristics that are expected for this type of program.³⁰ One of the characteristics is that the focus of the program must not be the generation of profits. The Guidance clarifies that it is possible for a charity to charge program participants or sell goods or services produced in the course of the program.³¹ This means that such charges and revenues must either meet the requirements to be a charitable program (especially under the CED Guidance in this context) or the requirements to be a related business under CRA’s policy on related business explained above.

2. Grants and Loans - Individual Development Accounts

There are two types of CED activities in relation to making grants and loans to eligible beneficiaries. The first type is individual development accounts (IDAs). IDAs are also permitted under the Former Guidance, except that expanded parameters are permitted under the new Guidance.

An IDA is a savings account that is intended to help an eligible beneficiary to save funds for a specific goal. For every dollar saved by the eligible beneficiary, the charity may make a matching grant at a pre-determined ratio over a specific period of time. For example, a charity and a disabled beneficiary may agree that the charity will deposit two dollars for every dollar that the beneficiary deposits until they have enough money to convert the beneficiary’s basement into a home office.

Under the Former Guidance, the charity is restricted to making contributions over one to three years, which appears to be expanded under the Guidance to “a specific period of time”, meaning that it could potentially be longer than three years.

³⁰ *Ibid.* These requirements are: instruction is provided to complement the on-the-job training, participants are employed for a limited period of time, the charity offers a job placement service to help graduates of the program find work in the labour force; the proportion of workers from the beneficiary group in relation to the total number of employees is 70% or higher, but alternative ratios may be justifiable if considerable supervision is required; and the focus of the activity must be to further a charitable purpose, not to generate revenue.

³¹ *Ibid.*, footnote 7, which provides caselaw reference for CRA’s position: *CIR v. Peebleshire Nursing Association*, (1927) 11 T.C. 335; *Everywoman's Health Centre Society (1988) v. Minister of National Revenue*, [1991] 2 C.T.C. 320, [1992] 2 F.C. 52(F.C.A.).

While under the Guidance, CRA recognizes that not only can IDAs be used to relieve poverty (such as by relieving unemployment of the poor), this is expanded under the Guidance. Specifically, the Guidance provides that IDAs may also be used for other charitable purposes (such as advancing education by providing employment-related training; or furthering a fourth category purpose by helping a disabled individual modify his or her home in order to operate a home-based business).³² This is a welcome expansion of what charities can use IDAs for, because under the Former Guidance, charities are restricted to using IDAs only for the purpose of helping low-income beneficiaries.

The Guidance imposes a new requirement that a charity engaging in IDA programs must be able to provide a policy showing the following: the criteria used to determine eligibility of a beneficiary, how the amount of an IDA is determined, the acceptable uses of the IDA, and when the eligibility of the beneficiary ceases. In order to pass the public benefit test, the charity must also be able to show that it only grants the amount necessary to achieve the charitable purpose. As well, CRA also requires the charity to limit the grants to what is needed to achieve its purpose.³³ Although not explicitly stated in the Guidance, it would go without saying that the charity would also need to ensure that the policy is implemented and provide supporting books and records to evidence the implementation.

3. Grants and Loans - Loans and Loan Guarantees to Beneficiaries

The second type of CED activities in relation to making grants and loans is the giving of loans and loan guarantees to eligible beneficiaries.

The ability of charities to provide loans, micro-loans and loan guarantees is expanded under the Guidance, as compared to the restrictions under the Former Guidance. Under the Former Guidance, charities can provide loans and loan guarantees only for the purposes of relieving poverty of hard-to-employ individuals to set up businesses, whereas under the new Guidance it is possible to operate these programs to advance education or other purposes that benefit the community. For example, the

³² *Ibid.*, paras. 25 and 27.

³³ *Ibid.*, para. 28-29.

Guidance states that a loan guarantee to an eligible beneficiary to help him or her attend courses to enhance their employment-related skills can be charitable.³⁴

It should be noted that the Former Guidance indicated that a charity conducting such CED activities should be able to provide a policy concerning when the charity considers that a recipient of support services or loans is a viable business and is no longer in need of such support. While the Guidance reiterates this requirement, it also requires that the policy include criteria for determining who the eligible beneficiaries are for such start up loans³⁵ and to provide a rationale and justification to show that its loans or guarantees do not exceed the amount needed to achieve its charitable purpose.³⁶

The Guidance explains when start-up loans and loan guarantees are acceptable and when they are not. It states that providing start-up loans and loan guarantees to establish businesses (including sole proprietorships or collective enterprises such as worker cooperatives) can be charitable if they directly further a charitable purpose. This type of activity also typically involves entrepreneurial training. On the other hand, the Guidance specifically points out that providing loans, start-up loans, and loan guarantees to promote entrepreneurship (such as to help entrepreneurs bring new and innovative ideas to the marketplace, or to promote business development) is generally not a charitable activity because the private benefit conferred is not incidental.³⁷

In terms of the amount of the loan involved, the Guidance states that loans and loan guarantees totalling less than \$10,000 will generally be considered to be a sufficient amount needed to achieve a charitable purpose. The intention of this requirement is to ensure that the program does not deliver a more-than-incidental private benefit. The Guidance also states that the determination will be fact-based in each case, suggesting a higher loan amount may be permitted if it is necessary to achieve the charitable purpose.³⁸ This seems to be a relaxation of the requirement in the Former Guidance that loans that exceeded \$25,000 or were consistently larger than \$10,000 suggested crossing the threshold between a charitable activity and a private benefit.

³⁴ *Ibid.*, para. 30.

³⁵ *Ibid.*, paras. 33- 34.

³⁶ *Ibid.*, para. 36.

³⁷ *Ibid.*, paras. 31, 32 and 83.

³⁸ *Ibid.*, para. 35.

The Guidance states that interest rates are generally expected to be at or below fair market value to allow greater charitable benefit to be delivered. However, CRA also accepts there may be circumstances when a higher rate is justified, such as where the terms allow the borrower to delay repayment and therefore flexibility may be as important a factor to some borrowers as the interest rate. As well, CRA accepts that a charity may generally justify charging an interest rate that covers, but does not exceed, its own borrowing rate and administrative costs, plus a loan-loss provision that is supported by the charity's actual loan-loss experience. As well, new charities can rely on the loan-loss experience of charities that operate similar programs.³⁹ Under the Former Guidance, an interest rate that yields a surplus may call into question whether or not the charitable purpose of the charity is being achieved by having a higher interest. CRA's expanded policy in the new Guidance is a welcome change.

Interestingly, there is no mention about community loan funds in the new Guidance, whereas there are a few paragraphs in the Former Guidance on this type of program. The Former Guidance provides that community loan funds, themselves operating a micro-enterprise program or lending money to charities operating such a program, are charitable. As well, the Former Guidance states that community loan funds lending money to non-qualified donees must qualify either as "straight investments" or the recipient non-qualified donee must be under contract to conduct a charitable program on behalf of the lending charity. The lack of any mention of this type of program in the Guidance leaves CRA's position on this matter unclear. As well, the previous requirement that community loan funds that were involved in lending money to non-qualified donees must qualify as "straight investments" would presumably no longer apply in light of the new parameters that charities may engage in program-related investments (see next section below).

4. Program-Related Investments

One of the most significant expansions of CRA's policy on CED activities is the broader context in which registered charities may engage in program-related investments (PRIs). Under the Former Guidance, charities are only permitted to engage in PRIs if made to qualified donees because of limitations of Canadian tax law requiring charities can only benefit qualified donees. However, under the new Guidance, CRA now accepts that charities can engage in PRIs that involve loans, loan

³⁹ *Ibid.*, footnote 8.

guarantees, share purchase and leases of land or buildings involving non-qualified donees as well, as long as they operate within the parameters set out in the Guidance. This shift in CRA's policy is a welcome change.

In general, a PRI is an activity that furthers the investor charity's charitable purposes. For this reason, the Guidance points out that a charity could simply fund a PRI-related activity out-right. The Guidance indicates that a charity may wish to engage in a PRI if it wishes to limit its involvement to investing capital that would be returned to the charity at the end of the program so that the capital can be used in other programs.⁴⁰ This is an important point because this may limit the nature of programs that may qualify as a PRI. However, the inability of the investor charity to use the PRI expenditure in meeting its disbursement quota requirements would be a disincentive on the charity to fund the activity as a PRI. CRA's rules on disbursement quota requirements are explained in the next section of this paper.

The Guidance explains that a PRI is not an investment in the conventional financial sense because while PRIs may generate a financial return, they are not made for that reason. As such, a PRI is not required to generate a return, or potential return, of capital (funds or property) for the charity, or to yield additional revenue (such as interest) for the charity at or above market rate.⁴¹

The Guidance stipulates that when making a PRI in a non-qualified donee, the PRI must be used for a program over which the investor charity maintains ongoing direction and control, so that the program is the investor charity's own activity (*i.e.*, this is the same as the "own activity" test that must be met when charities conduct activities through third party intermediaries⁴²); and the investor charity must show that any private benefit resulting from the PRI is incidental (necessary, reasonable, and not disproportionate to the resulting public benefit).⁴³ This would mean that on the flip side, if a charity cannot maintain direction and control over the activity carried out by a non-qualified donee, it could invest in, or provide resources to, the non-qualified donee at market rates (as a form of

⁴⁰ *Ibid.*, para. 41.

⁴¹ *Ibid.*, para. 40.

⁴² See CRA Guidance CG-004 *Using an Intermediary to Carry out a Charity's Activities within Canada*, June 20, 2011 (online: <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/ntrmdry-eng.html>), and CRA Guidance CG-002, *Canadian Registered Charities Carrying Out Activities Outside Canada*, July 8, 2010 (online: <http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/tsd-cnd-eng.html>).

⁴³ *Supra* note 1, paras. 45-49.

conventional financial investment) provided the investment meets the investor charity's conventional investment requirements.⁴⁴ In this regard, investment standards are imposed by provincial statutes regulating investments made by charities. The standard imposed varies from province to province. For example, charities that are incorporated in Ontario, have offices in Ontario, or invest charitable funds in Ontario, generally have to comply with the investment provisions of the *Trustee Act* (Ontario).⁴⁵ The Act imposes a prudent investment standard governing investment decision-making of trustees or boards of directors of charities, and permits charities to delegate their investment decision-making to qualified investment advisers under certain circumstances. Specifically, subsection 27(1) of the Act states that a trustee must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments.

The Guidance identifies four common types of PRIs: loans, loan guarantees, share purchases, and leases of land or buildings. This would imply that this list is not exhaustive and that other forms of PRIs are possible.

(a) Loan and loan guarantee - A charity may make a PRI in the form of a loan or loan guarantee similar to the policy regarding charities making loans as explained above. PRIs that are loans are expected to be at or below fair market interest rates so that greater charitable benefits can be delivered, although there may be circumstances under which a higher interest rate may be justified (such as by including other terms that would allow the borrower to delay repayment). A charity may also make a PRI in the form of a loan guarantee to help another organization to obtain a loan. The guarantee must be for a loan that will further the investor charity's charitable purposes.⁴⁶ In one of the examples given in the Guidance, a charity that has a purpose to relieve unemployment of individuals by providing job skills training makes a PRI in the form of a low-interest loan to a not-for-profit entity to provide job training programs on the charity's behalf to participants who meet the investor charity's appropriate eligibility criteria. The example specifically indicates that the not-for-profit is not connected to the investor charity.⁴⁷ It is not clear whether this is intended to imply that a charity is not permitted to make a loan or provide a loan guarantee to a non-qualified donee that is related to the charity, such as a not-for-profit trade association and a related educational charity.

⁴⁴ *Ibid.*, para. 50.

⁴⁵ R.S.O. 1990, c. T.23.

⁴⁶ *Supra* note 1, paras. 55-56.

⁴⁷ *Ibid.*, para. 42, example B.

(b) Share purchase - A charitable organization may make a PRI in the form of share purchases. However, there are limitations for foundations to engage in this type of activity (see comments below). A public or private charitable foundation can also make a PRI in this form, but neither can acquire a controlling interest in a company. In one of the examples given in the Guidance, a charity that has a purpose to relieve poverty by providing essential amenities of life makes a share purchase PRI in an arm's length corporation that operates a commercial apartment complex so that a proportionate number of units in the apartment complex are rented at reduced rates to poor individuals who satisfy the investor charity's appropriate poverty eligibility criteria.⁴⁸ Again, it is not clear whether the reference to an "arms length corporation" in the example is intended to imply that a charity is not permitted to make a share purchase PRI in a for-profit company in which the charity holds shares.

(c) Leasing land and buildings - A charity can also engage in PRIs in the form of leasing land and buildings. The Guidance does not provide many guidelines in relation to this form of PRI. To illustrate what it means, the Guidance does give the following example:⁴⁹

A charity that has a purpose to advance education leases a building to an arm's length organization (a non-qualified donee) at less than fair market value. The arm's length organization teaches English or French as a second language to help students develop the skills necessary to prepare for employment. The lease agreement between the charity and the arm's length organization states that all students have to meet the investor charity's appropriate eligibility criteria. The terms of the agreement include ongoing monitoring and reporting provisions to ensure the charity maintains the necessary direction and control over its activity, which is to teach eligible beneficiaries the language skills necessary to prepare them for employment.

The Guidance points out that there are limitations in how a private foundation may be restricted in engaging some forms of PRIs.⁵⁰ For example, private foundations cannot engage in any business activities, and therefore any PRIs that result in the generation of business income may put the charity off-side with the rules. Private foundations can make a share purchase PRI, but cannot acquire a

⁴⁸ *Ibid.*, para. 42, example A.

⁴⁹ *Ibid.*, para. 42, example C.

⁵⁰ *Ibid.*, para. 57, footnotes 10, 11, 14 and 15.

controlling interest in a company. Private foundations that acquire shares in a company must comply with the reporting and divestiture requirements of the excess business holding rules.⁵¹

The Guidance requires charities that conduct PRIs to have appropriate exit mechanisms in place to withdraw from a PRI or convert it to a regular investment. The charity should also have a written policy or other documentation that explains how each PRI furthers its charitable purpose and stipulates the criteria it applies to PRI decisions. If the charity makes a PRI to a non-qualified donee, the charity should maintain books and records evidencing direction and control over the activities. Also, the charity must ensure that its PRIs meet all applicable trust, corporate, or other legal or regulatory requirements.⁵²

It is also important to note that the Guidance recognizes that charities may engage an intermediary (*i.e.*, a non-qualified donee) to carry out the program financed by the PRI on its behalf, provided that the same requirements for maintaining direction and control over resources, avoiding non-incident private benefit, and including exit mechanisms are complied with.⁵³ As well, a specialized intermediary may also potentially qualify for registration as a charity on the basis that it is promoting the efficiency and effectiveness of charities. For example, a property management organization may be a specialized intermediary qualifying for registration as a registered charity on the basis that it manages only low-income housing properties which are owned by registered charities.⁵⁴

5. Accounting for Loans, Loan Guarantees and PRIs

The Guidance provides guidelines for charities on how to track loan, loan guarantees and PRIs on their financial statements and annual T3010 information return.

In this regard, the assets that have been loaned or used in making PRIs must be included in a charity's T3010 return, either as part of its total assets (in Section D) or accounts receivable (in Schedule 6).⁵⁵ Furthermore, such assets would not be included in the asset base for the purpose of

⁵¹ CRA Guide T2082, *Excess Corporate Holdings Regime for Private Foundations* (online: <http://www.cra-arc.gc.ca/E/pub/tg/t2082/t2082-10-e.html>).

⁵² *Supra* note 1, paras. 53-54.

⁵³ *Supra* note 42.

⁵⁴ *Supra* note 1, paras. 59-60.

⁵⁵ *Ibid.*, para. 61.

calculating the charity's 3.5% disbursement quota obligation requirements.⁵⁶ This would make sense because these assets are used in achieving their charitable purposes and therefore the assets are used in the course of the charities' charitable activities.

All interest and other income generated from a charity's loan or PRI activities must also be reported in the T3010 and be included in the asset base for the purpose of calculating the charity's 3.5% disbursement quota obligation requirements.⁵⁷

However, if a portion of any loan is held by the loan recipient for future use, that portion would also be included in the asset base when calculating the 3.5% disbursement quota obligation.⁵⁸ This would seem to be inconsistent with the Guidance where it indicates that loans are to be excluded from the asset base. It would appear that the Guidance is suggesting that the loans made to a recipient and spent by the recipient would not be included in the investor charity's asset base for calculating the 3.5% disbursement quota requirement, but if the loans are held by the recipient then the investor charity would have to include that amount in the asset base and be required to disburse 3.5% of it to meet its disbursement quota. If the investor charity does not have this amount of funds (because it is held by the recipient), it would seem odd that the investor charity would be required to disburse 3.5% of it when the investor charity is not even required to make a return from that loan in the first place to qualify as a PRI.

The Guidance states that a loan guarantee PRI is cost-neutral. It is not a debt at the time the loan is guaranteed. If the borrower defaults on the loan, and the charity has to honour the guarantee, the charity will be considered to have incurred a debt. Once the debt has been incurred, the charity has to report the debt as a liability. Any principal and interest paid can be reported as a charitable or other type of expenditure, as applicable.⁵⁹

However, loans, loan guarantees and PRIs are not recognized as charitable disbursements and cannot be used in meeting the charity's 3.5% disbursement quota except under two scenarios.

⁵⁶ *Ibid.*, para. 62.

⁵⁷ *Ibid.*, paras. 63-64.

⁵⁸ *Ibid.*, para. 65.

⁵⁹ *Ibid.*, para. 66.

First, if an investor charity is unable to recover part or all of the principal of a loan, the unrecovered amount is a charitable or other expenditure of the investor charity, depending on the purpose of the loan. In this scenario, this part of the loan can be used to meet its disbursement quota.⁶⁰

Second, if and only if, a charity fails to meet its disbursement quota requirement and the charity has made a loan or a PRI, then CRA may consider any opportunity cost resulting from these activities as equivalent to an expenditure. Specifically, the opportunity costs of PRIs are calculated as follows:⁶¹

- Loans: the outstanding loan multiplied by the difference between the interest rate the investor charity could have earned if it invested the amount in T bills or GICs, and the interest rate the charity received.
- Share purchase: the difference between the return the investor charity could have realized had it invested in T bills or GICs and the actual return or loss from purchasing shares.
- Lease: the difference between the fair market value of the lease and the actual amount the investor charity received from the lease.

It is difficult to understand the rationale for not permitting these expenditures as charitable disbursements for the purpose of meeting the disbursement quota obligation. This position would act as a deterrent for charities to give loans or engage in PRIs. Instead, it would encourage charities to find alternative ways to fund the programs (such as direct charitable programs). It appears that this position is premised on CRA's view (though not clear from the Guidance) that they are not used "directly" on charitable work. If CRA accepts that a charity engaging in loans and PRIs must do so in furtherance of the charity's charitable purposes, then assets used as such should qualify to be included as charitable disbursements in meeting its disbursement quota. As well, if these expenditures are not charitable disbursements, it would be difficult to understand why lost opportunity costs associated with these disbursements may be considered to be counted towards meeting the charity's disbursement quota when the charity has a problem meeting its disbursement quota. If lost opportunity costs could be allowed to meet the disbursement quota if there is a problem in meeting it, it means that these expenditures are charitable. If so, then there would appear to be no reason why they would not be permitted in meeting the disbursement quota in the first place.

⁶⁰ *Ibid.*, para. 67.

⁶¹ *Ibid.*, para. 68.

6. Social Businesses for Individuals with Disabilities

CED activities can involve charities operating social businesses that employ people with disabilities. The Former Guidance refers to this type of activities as “sheltered workshops”. The Guidance adopts the definition in the *Canadian Human Rights Act*⁶² to mean any previous or existing mental or physical disability and includes disfigurement and previous or existing dependence on alcohol or a drug. Social businesses may provide services, sell goods, manufacture articles, or undertake other kinds of work. It may also operate a retail outlet or send products manufactured to be sold at stores. Unlike on-the-job training, social businesses may provide permanent employment. It is important to note that this type of CED activity is restricted for persons with disabilities. Therefore, an activity established to help other beneficiaries (such as a workshop for the poor) would not meet the requirements as a social business under the Guidance.

A social business is required to have the following characteristics: (a) the workforce must consist entirely of individuals with disabilities, with the exception of employees who provide necessary training and supervision; and (b) the work is specifically chosen and structured to take into account the special needs of individuals with disabilities and to relieve conditions associated with those disabilities. As well, the following characteristics are generally expected but are not required: (a) provision of associated job-related training that enhances the general skills of the eligible beneficiaries; and (b) having significant involvement of eligible beneficiaries in managing and making decisions. As with on-the-job training, the CRA does not prohibit a social business from earning a profit, as long as the focus is on helping eligible beneficiaries.⁶³

These requirements are generally similar to those set out in the Former Guidance. Key differences include: (a) Whether the charity involved receives government grants is no longer a relevant consideration, and the workers involved are no longer expected to sit on the board of directors of the charity involved; (b) The new Guidance no longer recognizes operating thrift stores and similar outlets (in sections of a community inhabited largely by the poor, selling donated goods at a low price, and operating on a break-even basis) to be a CED activity.

⁶² R.S.C. 1985, c. H-6, s. 25.

⁶³ *Supra* note 1, paras. 69-74.

F. COMMUNITY LAND TRUSTS

Community land trusts ensure that land will remain available for the benefit of a community. Typically, community land trusts operate by developing properties and leasing them to eligible beneficiaries. Operating a community land trust may be a charitable activity if it directly furthers a head of charity.⁶⁴

G. PROMOTION OF COMMERCE OR INDUSTRY

CED activities that promote commerce or industry can be charitable by benefiting the public or a sufficient section of the public and not a specific eligible beneficiary. The Guidance states that these activities may promote a particular industry or trade, as long as they focus on benefiting the public, not the members of the industry. The new Guidance states that charities may conduct CED activities to promote a particular industry or trade such as agriculture, horticulture, or craftsmanship, which is a welcome expansion of the Former Guidance.⁶⁵ The Former Guidance states the narrow view that only promotion of agriculture and craftsmanship could be charitable.

The Guidance includes examples of purposes that could enhance an industry while also potentially delivering a charitable public benefit, which were not included in the Former Guidance: promote greater efficiencies within an industry, if those efficiencies benefit the general public, or promote and facilitate the achievement, preservation and maintenance of high standards of practice within an industry, if doing so benefits the general public. Activities that could further these purposes and result in a tangible benefit are also given in both the Former Guidance and the Guidance, including conducting research to establish the socio-economic profile of a community and identify potential economic opportunities; holding public exhibitions of a community's agricultural products and services that include prizes being awarded to promote excellence; encouraging excellence in the products and services of an industry by holding industry-wide competitions or creating industry-wide standards.⁶⁶ However, the Guidance specifically points out that promoting entrepreneurship by helping entrepreneurs bring new and innovative ideas to the marketplace; and promoting business

⁶⁴ *Ibid.*, paras., 75, 76.

⁶⁵ *Ibid.*, paras., 77, 78.

⁶⁶ *Ibid.*, paras. 77-80.

development by providing funding (including start-up loans), and mentorship programs are not charitable.⁶⁷

The Guidance also indicates that for organizations conducting activities that promote commerce or industry wishing to apply for charitable status, non-expert opinions from the founders, directors, trustees, members or supporters of an organization are not relevant when determining whether a benefit to the public will result from promoting an industry. As well, an expression of non-expert opinion or belief, or merely stating that a public benefit will result from a purpose, is not enough. In this regard, it would be best to obtain independent and object expert opinions on the matter before applying for registration.⁶⁸

H. CED ACTIVITIES IN AREAS OF SOCIAL AND ECONOMIC DEPRIVATION

The Guidance states that CED activities may be charitable if they improve socio-economic conditions for the public benefit in an area of social and economic deprivation (which are also known as deprived areas). In this regard, this type of activity is referred in the Former Guidance as “economically challenged communities”.

The Guidance provides that deprived areas are geographic communities that generally display high rates (at least 1.5 times the national average) of a number of characteristics. The list of characteristics is very similar to the list in Former Guidance. In general, the characteristics include: unemployment for two or more consecutive years; crime (including family violence); health problems (including mental health issues, drug and alcohol addiction, and suicide); and children and youth at risk (taken into care or dropping out of school). As well, the deprived area must be large enough for the beneficiaries to form a sufficient segment of the public. If a deprived area no longer displays any of the characteristics set out above for four consecutive years, it no longer qualifies as a deprived area and the charity will have two years to wind up its CED activities in the area.⁶⁹

⁶⁷ *Ibid.*, para. 83.

⁶⁸ *Ibid.*, para. 82.

⁶⁹ *Ibid.*, paras. 84-87, footnote 27.

I. CONCLUSION

The Guidance takes a number of positive steps to facilitate charities engaging in CED programs. In particular, charities no longer have to ensure they do not make a profit from activities to relieve unemployment or social businesses, as long as this is not the focus or goal of the activities. It must, however, be remembered that CED activities are not related business activities. CED activities are not activities that are conducted for the purpose of providing an income stream, but are activities conducted to benefit beneficiaries that are charitable at law.

The sector must also remember that CED activities are not necessarily the same as social enterprise, although they have much in common. The fact that an activity is referred to in the sector as community capacity building, social enterprise or social finance does not automatically mean that they meet CRA's requirements to be a charitable activity. As such, before a charity engages in such an activity, it must ensure that the proposed activity meets CRA's requirements within the framework of the *Income Tax Act* and CRA's administrative policies.

As well, charities looking to make PRIs can now do so in non-qualified donees. However, it is unfortunate that the entire amount of a PRI still does not count towards meeting a charity's disbursement quota and the lost opportunity costs associated with these disbursements may only count towards meeting the charity's disbursement quota if the charity has a problem meeting its disbursement quota.

The Guidance specifically requires charities engaging in CED activities to adopt and implement policies in support of the activities to ensure that they are charitable, and to keep sufficient books and records to evidence compliance with CRA's requirements. As well, it would be prudent for directors and trustees to be reviewing their governing documents to ensure that CED activities are achieving the charitable purposes of their organization. Since the Guidance sets out a number of new requirements on CED activities and there is no grandfathering of activities that are currently undertaken under the Former Guidance, it is important for all charities that currently engage in CED activities to carefully review their existing programs and to make necessary changes in order to ensure compliance with these new requirements.

Lastly, although the Guidance expands the parameters within which charities may engage in CED activities, the ability of private foundations to take advantage of these new expanded requirements are limited because of the rules under the *Income Tax Act* that apply to private foundations (such as private foundations cannot engage in any business activities, and must comply with the excess business holdings rules). As such, private foundations that conduct CED activities would need to carefully review all of their CED programs to ensure that they are not off-side with these rules.