
FUNDING THE SECTOR – THE NEED FOR SUBSTANTIAL REFORM

*By Donald J. Bourgeois**

While I was on a recent trip to Rome - marvelling at the heritage that surrounds you, the legacy of infrastructure dating back two millennia, of artistic expression and creativity that spans centuries, and of support for the charitable or not-for-profit sector – several newspaper articles were run which speak to the funding difficulties for the sector in Canada. One of the articles reported on the Canadian Heritage Minister's speech that the arts and culture sector needed to find other sources of revenues than governments. This pronouncement, at least as it was reported, seemed to suggest that the charitable or not-for-profit sector – not just the arts and culture component – was oblivious to the risks of relying upon one primary source of revenue. Those risks are exacerbated by a government that is erratic in its approach to funding and to the sector, and one that has not defined its objectives, much less a clear public policy for the sector.

While the problems are readily apparent, and have been noted repeatedly, the solutions are not. There are limited sources of revenue for an organization, be it one that is involved in arts and culture, education, religion, or social services. Those sources include grants from governments (federal, provincial, municipal) and their agencies, private sector sponsorships, private donations, membership fees, and volunteer in-kind contributions.

Investment income is another source, but few organizations have sufficient investments to generate any reasonable and reliable level of income – and those organizations tend to be educational, health care and similar institutions that receive substantial allocations from governments for both capital and operating

* Donald J. Bourgeois, B.A., LL.B., is counsel to Carters Professional Corporation on charitable matters.

expenses. Changes to the *Income Tax Act* have also complicated the situation for organizations that do have investments. These investments have been considered as enduring property in a convoluted formula that is difficult to comprehend for most volunteers and many professionals in the sector.

There are two other sources of revenue – earned revenues and “reduced expenses.” This latter opportunity is not a direct source of revenue for most organizations, but clearly a reduction in expenditures allows an organization to operate with a lower budget or expand its operations in other, more beneficial, ways.

The difficulty for many organizations is the lack of clarity around what organizations may and may not do with respect to earned revenue and using other organizations to provide certain services. Earned revenue has historically been limited to the income earned from charging for the goods and services provided by an organization as part of its mandate – a charitable performance organization earns income from the sale of tickets to the public; a social service agency charges for meals, albeit at a reduced rate. It is this “albeit,” though, that runs through Canada Revenue Agency’s (CRA’s) approach to earned income. Organizations have difficulty complying with CRA’s approach and “turning a profit” on earned income. Any organization that looked to budgeting profits on an ongoing basis would certainly need to have in its back pocket a strong legal opinion and accounting advice to support its position.

While the Minister speaks of the need for the sector not to rely on a few pillars of support, the reality is that there are only a few pillars upon which most organizations can rely without risking registration as a charity. That asset, of course, is critical to the long term success of the organization. Organizations cannot easily experiment with other forms of revenue, including evolving concepts. The legal structure put in place is one obstacle. Another is the very low tolerance level most organizations have for errors.

One relatively minor error can kill an organization because it has no financial flexibility and, realistically, little hope to obtain financing. By their nature, charities cannot obtain “capital financing” as do businesses. A charity, with very few exceptions, cannot issue bonds or shares to “capitalize.” Similarly, loans are limited, both by statutory and common law, and by the reality that most financial institutions want low exposure in this area. A financial institution will want to ensure, naturally, repayment of the loan, and it will look to the certainty of cash-flow (especially from governments) to be security for the loan. No government grant, no loan.

“Social enterprise” is a good example of where many organizations would like to go, but there would appear to be significant obstacles put in place by the federal government and, to a lesser extent, provincial governments, to social enterprise. Social enterprise is not new. But it has taken on a renewed vigour in the last few years, and there is certain ambiguity about what it means in all cases. Recent articles in the *Financial Post* and other newspapers and journals (including upcoming articles in *The Philanthropist*) have highlighted social enterprise as a possible solution. One newer form of social enterprise is social financing, whereby funds could be used to finance other organizations or to provide the security for institutional loans.

The second area noted above is the reduction in costs. While some movement has occurred within CRA towards “umbrella organizations,” there are significant obstacles remaining. Not least of these obstacles is the requirement that umbrella organizations only benefit registered charities. While some limits are likely reasonable and necessary to avoid abuse, other strict limitations make it difficult for the sector to structure itself to take advantage of umbrella organizations to provide cost effective services.

The Minister was correct that there is a need for the sector to look to other pillars of support. But the Minister did not go far enough in his pronouncement. For the sector to do so in reality, and from a practical perspective, will require significant changes to how earned revenue, social enterprise, social financing, umbrella organizations, shared services, and so forth, are viewed by Ottawa. The Ministry of Finance and Canada Revenue Agency need to be engaged in an open dialogue with the sector towards meeting the objectives of the Canadian Heritage Minister.