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# 2013 NATIONAL CHARITY LAW SYMPOSIUM

Toronto – May 10, 2013

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## An Overview of CRA's Community Economic Development Guidance, Including Program Related Investments

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By Theresa L.M. Man, B.Sc., M.Mus., LL.B., LL.M  
tman@carters.ca  
1-877-942-0001


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<b>AN OVERVIEW OF CRA'S COMMUNITY ECONOMIC DEVELOPMENT GUIDANCE, INCLUDING PROGRAM RELATED INVESTMENTS</b>	
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<b>A. INTRODUCTION</b>	
<ul style="list-style-type: none"><li>On July 26, 2012, Canada Revenue Agency (CRA) released Guidance CG-014, <i>Community Economic Development Activities and Charitable Registration</i> <a href="http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/cmycnmcdvpm-eng.html">http://www.cra-arc.gc.ca/chrts-gvng/chrts/plcy/cgd/cmycnmcdvpm-eng.html</a></li><li>Former Guidance had been in effect since 1999</li><li>New Guidance is a marked improvement over the former Guidance</li><li>Expands what charities can do, sets out clear boundaries and provides examples</li></ul>	
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<b>B. CED AND SOCIAL ENTERPRISE</b>	
<ul style="list-style-type: none"><li>Community Economic Development ("CED") generally refers to activities that improve economic opportunities and social conditions of an identified community</li><li>An "identified community" can be either a geographic community or a group of eligible beneficiaries</li><li>CED activities are often referred to as "social enterprise" or "social finance", but they may not necessarily be CED activities for purposes of the Guidance<ul style="list-style-type: none"><li>BC - community contribution companies</li><li>Nova Scotia - community interest companies</li></ul></li></ul>	
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**C. BASIS AT LAW FOR CED ACTIVITIES**

- Charities can conduct CED activities as long as they
  - Further the charity’s charitable purpose
  - Meet the public benefit test
  - Meet the requirements for eligible beneficiaries
- CED activities are charitable activities
- Not related business activities

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**1. Furthering a Charitable Purpose**

- The law in Canada does not recognize CED as a charitable purpose in and of itself
- To be charitable, CED activities must directly further a charitable purpose
  - Relief of poverty
  - Advancement of education
  - Benefit to the community in ways the law regards as charitable
- New Guidance did not include “advancement of religion”
- But no reason why CED cannot further advancement of religion, e.g., micro loans for the poor as a manifestation of one’s faith

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- Given CRA’s omission, religious charities may want to implement CED activities that further one of its other charitable purposes
- Religious charities should review their objects/purposes in their constating documents to ensure that planned CED activities are within their charitable purposes

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**2. Meeting the Public Benefit Test**

- To be charitable, CED activities must also meet the public benefit test, i.e., a significant portion of the public
- Cannot provide any private benefit that is more than incidental
  - i.e., any benefit received by an individual or organization that is not an eligible beneficiary and derives from a charity's activity must be necessary, reasonable, and not disproportionate to the public benefit

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**3. Helping Eligible Beneficiaries**

- Each charitable purpose has specific requirements relating to eligible beneficiaries
- Examples in Guidance
  - For relief of poverty, eligible beneficiaries must be poor
  - For relief of conditions associated with disabilities, eligible beneficiaries must be individuals with conditions associated with the disability
  - For relief of unemployment, beneficiaries must be unemployed or facing a real prospect of imminent unemployment and in need of assistance

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**D. TYPES OF CED ACTIVITIES**

- CED activities “generally” fall into one of five main categories:
  - Activities that relieve unemployment
  - Grants and loans to eligible beneficiaries
  - Program-related investments
  - Social businesses for individuals with disabilities
  - Community land trusts
- Not an exhaustive list

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**E. ACTIVITIES THAT RELIEVE UNEMPLOYMENT**

- Not charitable to provide employment or help people find employment if these services are provided to the public at large
- Can only be provided to beneficiaries who are exclusively
  - Unemployed or facing a real prospect of imminent unemployment, and
  - Are shown to need assistance (i.e., they do not have the resources or skills to help themselves)

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- Examples of activities
  - Employment related training
  - Career counseling
  - Establishing lists of available jobs
  - Providing referral services to appropriate agencies
  - Providing assistance with résumés or preparing for job interviews
  - Helping unemployed individuals obtain employment insurance
- This general guideline is much more helpful than the former Guidance, which restricted CED employment programs to helping "hard-to-employ" individuals who met a list of 9 criteria or persons below the poverty line

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- Examples of employment-related training include:
  - (1) Employability training: developing employment skills - such as ESL or life skills (e.g., time management and interpersonal skills)
  - (2) Entrepreneurial training: providing instruction on preparing a business plan, preparing financial statements, etc.
  - (3) On-the-job training: providing on-the-job training in vocational or work skills that enhance employability
    - Must focus on providing training, not jobs
    - Must not focus on generating profits
    - Previously called "training business"

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**F. GRANTS AND LOANS TO ELIGIBLE BENEFICIARIES**

- Two types activities:
  - Individual development accounts (IDAs)
  - Loans and loan guarantees
- Both provide opportunities to engage and empower beneficiaries in their own development, i.e., "a hand-up instead of a hand-out"

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**1. Individual Development Accounts (IDAs)**

- IDAs are savings accounts that help eligible beneficiaries save for an agreed upon goal
- Examples of goal
  - Modify home to operate a home-based business for a disabled person
  - Funds to buy tools for an unemployed trades person
  - Funds for employment-related education, including post-secondary education
- For every dollar the eligible beneficiary saves during a specific period, the charity contributes a pre-determined amount

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- IDA no longer restricted to relieving poverty - can use IDAs to advance education or to further a fourth head purpose
- Charities must have a policy
  - Criteria used to determine who is an eligible beneficiary
  - How the amount of an IDA is determined
  - Acceptable uses of an IDA
  - When the eligibility of the beneficiary ceases, based upon predetermined criteria
- To pass the public benefit test, the charity must not grant more to the beneficiary than is necessary to achieve the charitable purpose

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**2. Loans and Loan Guarantees**

- Guidance expands the ability of charities to provide loans, including micro-loans and loan guarantees
- Charities can operate these programs to advance education or other purposes that benefit the community, not just to relieve poverty
  - e.g., loan guarantees to eligible beneficiaries to help them attend courses to enhance their employability or help to establish a business
- Charities required to have a policy
  - Who is eligible for a loan or loan guarantee
  - Appropriate amount
  - When a recipient will be considered to no longer need this support and how the loan will be repaid

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- Providing start-up loans and loan guarantees to establish businesses can be charitable
  - Assistance must further a charitable purpose, not simply promote entrepreneurship
  - Loans should generally be under \$10,000
- But promoting entrepreneurship is not charitable - e.g., help entrepreneurs bring new and innovative ideas to the marketplace, or to promote business development
- Generally, interest rates should be at or below fair market value - can be exceptions e.g.,
  - Terms of the loan permit the borrower to delay repayment, or
  - If there is a high loan-loss ratio

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**G. PROGRAM-RELATED INVESTMENTS (PRIs)**

- One of the most significant expansions of CRA's policy in the new Guidance is the broader context in which charities may engage PRIs
- PRIs are an innovative way in which charities can become involved in social enterprise related activities
- Even if a charity does not engage directly in social enterprise activities, it can participate by investing in social enterprise activities that achieve a charitable purpose of the charity

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**1. What are PRIs?**

- PRIs are investments that directly further the charitable purposes of the charity
- PRIs are not investments in the conventional financial sense
  - PRIs may generate a financial return, they are not made for that reason
  - PRIs are not required to generate a return of capital for the charity or yield interest
  - Yield from the investment can be below market rate
  - Charities do not have to act like a “prudent investor”

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**2. Conducting PRIs with Non-Qualified Donees**

- Charities were previously restricted to making PRIs with qualified donees
- Guidance now permits charities to make PRIs with non-qualified donees so long as the charity maintains direction and control over the program to achieve the charitable purpose
- Requirement is identical to the “own activity” test required when conducting activities through third party intermediaries inside or outside of Canada
- Must also show that any private benefit is incidental

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**3. Types of PRIs**

- Loans and loan guarantees - to another organization to allow it to achieve the charitable purpose of the investor charity, e.g., to acquire job training equipment for eligible beneficiaries
- Leasing land and buildings - buying a building and leasing it to an organization to accomplish a charitable purpose, e.g., for education purposes

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- Share purchases - in a for-profit company to accomplish charitable purpose, e.g., operating an apartment complex for the poor
  - However, foundations cannot acquire a controlling interest in a company
  - Private foundations are also subject to other restrictions, such as divestment obligations for shareholdings above 20%, under the excess corporate holding regime

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#### 4. Requirements of Charities Engaging in PRIs

- Charities conducting PRIs must have
  - A policy describing how the charity will make decisions regarding PRIs
  - Documentation explaining how each PRI furthers its charitable purpose
  - Exit mechanisms to withdraw from a PRI or convert it to a regular investment if it no longer meets the charity's charitable purpose
  - Evidence of direction and control over PRIs to non-qualified donees
  - Must also meet all applicable trust, corporate and other legal and regulatory requirements

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#### 5. Accounting for PRIs and Loans

- Charities must account for their assets contributed to PRIs and loans in their financial statements and annual T3010 information returns
- Include PRIs in total assets or accounts receivable - not included in the asset base for 3.5% disbursement quota (DQ)
- Include interest and other income earned from PRIs and loans - included in the 3.5% DQ asset base
- If loan is held by recipient for future use - include in 3.5% DQ asset base

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- Unfortunately, loans, loan guarantees and PRIs are not charitable expenditure, cannot be used to meet 3.5% DQ
  - Except - if a charity does not meet its disbursement quota, CRA *may* consider the lost opportunity cost of the charity's PRIs as equivalent to expenditures
- CRA's position may deter charities from engaging in PRIs and may force charities to find traditional ways to fund a particular program (such as conducting the program directly)
- Since PRIs must further the charity's charitable purposes, the assets contributed should qualify as charitable disbursements in meeting the 3.5% disbursement quota

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#### H. SOCIAL BUSINESSES FOR INDIVIDUALS WITH DISABILITIES

- "Disability" means a previous or existing mental or physical disability, and includes disfigurements and previous or existing dependence on alcohol and drugs
- Provides permanent employment to persons with disability, not simply on-the-job training or other limited time employment
- May provide services, sell goods, manufacture articles, operate retail outlets or undertake other kinds of work
- May directly employ eligible beneficiaries and may provide technical assistance and materials to them
- May earn a profit, as long as the focus is on helping eligible beneficiaries

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- Required characteristics:
  - Workforce must consist entirely of individuals with disabilities, with the exception of employees who provide necessary training and supervision
  - Work is chosen and structured to match the special needs of individuals with disabilities and to relieve conditions associated with those disabilities
- Characteristics are generally expected but not required
  - Job-related training that enhances the general skills of the eligible beneficiaries, and
  - Significant involvement of eligible beneficiaries in managing and making decisions

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**I. COMMUNITY LAND TRUSTS**

- A community land trust may be a charitable activity if it directly furthers a charitable purpose
- Community land trusts ensure that land will remain available for the benefit of a community
- Typically, community land trusts develop properties and lease them to eligible beneficiaries
- e.g., a charity that relieves poverty purchases a residential building and provides low income housing to people who are poor

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**J. PROMOTION OF COMMERCE OR INDUSTRY**

- CED activities that promote commerce or industry (such as agricultural, horticultural or craftsmanship) can be charitable if they are for the public benefit - not a particular eligible beneficiary group
- Examples of acceptable purposes
  - Increasing efficiencies within an industry, if those efficiencies benefit the general public
  - Promoting high standards of practice within an industry, if doing so benefits the general public
- For example - holding public exhibitions of a community's agricultural products and services that include prizes awarded to promote excellence

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- At common law, a charitable benefit must be recognizable and capable of being proved and socially useful, a benefit must generally be tangible or objectively measured
- Application for charitable status - when determining whether promoting an industry will benefit to the public
  - Non-expert opinions from founders, directors, trustees, members or supporters are irrelevant
  - Therefore best to obtain independent and objective expert opinions
- But promoting entrepreneurship by helping entrepreneurs bring new and innovative ideas to the marketplace; and promoting business development by providing funding (including start-up loans), and mentorship programs are not charitable

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**K. CED ACTIVITIES IN AREAS OF SOCIAL AND ECONOMIC DEPRIVATION**

- CED activities may be charitable if they improve socio-economic conditions for the public benefit in areas of social and economic deprivation (known as "deprived areas")

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- Deprived areas are geographic communities that display high rates (at least 1.5 times the national average) in one of the following characteristics for four consecutive years:
  - 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)

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- 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 years in a row, the charity will have two years to wind up its CED activities in the area
- Special consideration relating to the assessment of private benefits are generally allowed in deprived areas
  - e.g., if a deprived area has a shortage of health care professionals, offering health professionals inducements (private benefits) might directly further the fourth head purpose of improving the socio-economic conditions in the deprived area

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**L. CONCLUSION**

- New Guidance takes a number of very positive steps to allow charities to engage in CED programs - such as conducting PRIs with non-qualified donees
- But there are limitations for foundations (especially private foundations) to engage in CED activities
- Charities considering becoming involved in CED need to be alert to the requirements to adopt and implement policies in support of CED activities to ensure that the activities are charitable

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- Important to understand that CED activities are charitable activities, not related business activities
- Also important to understand that CED activities are not the same as social enterprise activities
- Must be prudent in keeping adequate books and records to evidence compliance with CRA's requirements

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