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

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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
• Former Guidance had been in effect since 1999
• New Guidance is a marked improvement over the former Guidance
• Expands what charities can do, sets out clear boundaries and provides examples

B. CED AND SOCIAL ENTERPRISE
• Community Economic Development ("CED") generally refers to activities that improve economic opportunities and social conditions of an identified community
• An "identified community" can be either a geographic community or a group of eligible beneficiaries
• 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
  – BC - community contribution companies
  – Nova Scotia - community interest companies
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

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

- 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 constituting documents to ensure that planned CED activities are within their charitable purposes
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

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

4. 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
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)

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.

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”
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”

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 predetermined amount

- 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
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?

• 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.

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.
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”

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

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
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

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
• 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

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

• 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
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.

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.

- 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.
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”)

• 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)

• 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
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

• 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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