
**THE OTTAWA REGION
Charity & Not-for-Profit Law Seminar**

Ottawa – February 7, 2013

**Practical Implications of CRA's
Community Economic Development Policy**

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A. INTRODUCTION


- Some.....
- On July 26, 2012, Canada Revenue Agency (CRA) released Guidance CG-014, *Community Economic Development Activities and Charitable Registration* (the New Guidance)
- The Former Guidance had been in effect since 1999
- For a detailed discussion of the New Guidance, see Charity Law Bulletin No. 287 at www.charitylaw.ca

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- Whereas the Former Guidance was overly prescriptive, the New Guidance expands what charities can do, sets out clear boundaries and provides examples
 - As such, it then leaves charities to do what they do best:

**Find innovative ways to achieve their
charitable purpose**



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B. WHAT IS COMMUNITY ECONOMIC DEVELOPMENT (CED)?


- CED generally refers to activities that “improve economic opportunities and social conditions of an identified community.”
- CED activities are often referred to as “social enterprise” or “social finance”
- e.g.:
 - Micro-loans
 - Businesses for the disabled
 - Employment training for the unemployed



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C. CAN CHARITIES ENGAGE IN CED?




- 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

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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
 - Therefore, to be considered “charitable”, CED activities must directly further a charitable purpose
 - i.e. relief of poverty, advancement of education and benefit to the community (fourth head)
- The New Guidance, though, omits “advancement of religion” from its list of charitable purposes that can be furthered by CED activities



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- But there should be no reason why CED cannot further advancement of religion,
 - e.g. micro loans for the poor as a manifestation of one's faith
- However, given CRA's omission, religious charities may want to implement CED activities that further one of its other charitable purposes
- As such, prior to implementing these activities, 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
- Part of this test is that a charity's activities cannot provide any private benefit that is more than incidental
- Which is to say, any benefit that is 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. Requirements for Eligible Beneficiaries

- Each charitable purpose has specific requirements relating to eligible beneficiaries
- e.g.:
 - For relief of poverty, eligible beneficiaries must be poor
 - For relief of conditions associated with disabilities, eligible beneficiaries must have a disability
 - For relief of unemployment, beneficiaries must be unemployed

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D. TYPES OF CED ACTIVITIES

- CED activities generally fall into one of five main categories, which are each described below in more detail:
 - Activities that relieve unemployment
 - Grants and loans to eligible beneficiaries
 - Program-related investments
 - Social businesses for individuals with disabilities
 - Community land trusts

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E. ACTIVITIES THAT RELIEVE UNEMPLOYMENT

- It is not considered charitable to provide employment or help people find employment if these services are provided to the public at large
- To be charitable, activities to relieve unemployment must involve individuals who are either unemployed or facing imminent unemployment
- Examples of activities that relieve unemployment are:
 - Employment related training
 - Career counseling
 - Establishing lists of available jobs

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- Given the state of the economy and the level of unemployment, there is much work that charities can do in this area, including religious charities



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- Examples of employment-related training include
 - (1) Employability training: developing employment skills, such as English language instruction, or life skills, such as time management
 - (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
 - On-the-job training programs must focus on providing training, not jobs, so is not permanent

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- However, to pass the public benefit test, the emphasis of these activities must be helping beneficiaries find employment, not helping employers recruit employees
- CRA permits charities to generate incidental profits from the program, but profit generation cannot be the focus
 - CRA considers activities aimed at profit generation to be unrelated business, which charities are prohibited from conducting

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F. GRANTS AND LOANS TO ELIGIBLE BENEFICIARIES

- There are two types of CED activities in relation to making grants and loans to eligible beneficiaries (i.e. to people who are poor):
 - Individual development accounts (IDAs)
 - Loans and loan guarantees
- Both of these types of activities 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 account that help eligible beneficiaries save for an agreed upon goal
- Agreed upon goals could include:
 - Modify home to operate a home-based business
 - Funds to buy tools for a trades person
 - Funds for 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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- e.g. a charity deposits two dollars into the development account for every dollar that an eligible beneficiary deposits until the beneficiary has enough money to convert his basement into a home office

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- The New Guidance expands the parameters under which IDAs are permitted
 - IDAs are no longer restricted to relieving poverty, as charities can now use IDAs to advance education or to further a fourth category purpose
 - Previously, charities could only contribute over a one to three year period, the New Guidance seems to expand this to "a specific period" but no time limit

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- However, charities providing IDAs must have a policy stipulating:
 - The criteria used to determine the eligibility of a beneficiary,
 - How the amount of an IDA is determined,
 - The acceptable uses of an IDA, and
 - When the eligibility of the beneficiary ceases.
- 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


- The New Guidance expands the ability of charities to provide loans, including micro-loans and loan guarantees
- Charities can now 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



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- Charities providing loans or loan guarantees should have a policy outlining how the charity will determine:
 - Who is eligible for a loan or loan guarantee
 - The 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 for an eligible beneficiary
 - However, this assistance must further a charitable purpose, not simply promote entrepreneurship
 - Loans should generally be under \$10,000
- Generally, interest rates should be at or below fair market value, but exceptions may be justifiable, 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


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 because, while PRIs may generate a financial return, they are not made for that reason
- As such, PRIs are not required to generate a return of capital for the charity or yield interest
- i.e. the yield of revenue can be below market rate

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- This distinguishes a charity's obligations when making PRIs from its obligations when making typical investments, as charities do not have to act like a "prudent investor" when conducting PRIs
- CRA has in essence recognized that a charity can achieve its charitable purposes by investing its capital instead of simply spending it
- Charities are also now allowed to conduct PRIs with non-qualified donees



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2. Conducting PRIs with Non-Qualified Donees

- Charities were previously restricted to making PRIs with qualified donees, which are primarily other registered charities, as well as municipalities, the UN and its agencies, etc.
- However, charities can now make PRIs with non-qualified donees so long as the charity maintains direction and control over the program to achieve the charitable purpose
- This requirement is identical to the “own activity” test required when conducting activities through third party intermediaries inside or outside of Canada

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3. Types of PRIs

(a) Loans and loan guarantees – to another organization to allow it to achieve the charitable purpose of the investor charity, e.g. making a loan to a third party to acquire job training equipment for eligible beneficiaries

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graph LR; Charity --> ThirdParty[3rd Party]; ThirdParty --> Beneficiaries[Eligible Beneficiaries];
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(b) Leasing land and buildings – buying a building and leasing it to an organization to accomplish a charitable purpose, e.g. for education purposes

(c) Share purchases – charities can now purchase shares in a for-profit company to accomplish their charitable purpose, e.g. operating an apartment complex for the poor

- However, public and private 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%

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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

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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 these in total assets or accounts receivable
 - Include interest and other income earned from PRIs and loans



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6. PRIs and the Disbursement Quota

- Charities do not have to include the assets they have contributed to PRIs in their assets base when calculating their 3.5% disbursement quota
- Unfortunately, charities cannot use the cost of their PRIs towards meeting their 3.5% disbursement quota
- The New Guidance states only that, 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

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- This policy position by CRA may act to 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)
- Charities with large investment asset bases may refrain from engaging in PRIs if they are concerned about meeting their 3.5% disbursement quota
- 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

- CRA defines "disability" as a previous or existing mental or physical disability, including previous or existing alcohol or drug dependence
- Social businesses seek to provide permanent employment, not simply on-the-job training



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- Social businesses may provide services, sell goods, manufacture articles, operate retail outlets or undertake other kinds of work.
- Social businesses must have the following characteristics:
 - The workforce must consist entirely of individuals with disabilities, with the exception of employees who provide necessary training and supervision
 - The work is chosen and structured to match the special needs of individuals with disabilities and to relieve conditions associated with those disabilities

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- As well, the following 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
- As with on-the-job training, CRA does not prohibit a social business from earning a profit, as long as the focus is on helping eligible beneficiaries

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I. COMMUNITY LAND TRUSTS

- 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 can be charitable by benefiting the public and not necessarily a particular eligible beneficiary group
- Purposes that could enhance an industry while also delivering a charitable public benefit include:
 - 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




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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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- 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, 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

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L. CONCLUSION

- 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
- Charities must also be prudent in keeping books and records to evidence compliance with CRA's requirements

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- With that said, the New Guidance takes a number of very positive steps to facilitate charities engaging in CED programs
- These include expanding PRIs such that charities may now make PRIs with non-qualified donees
- Charities will now have new ways to achieve their charitable purpose within the framework of what CRA considers to be charitable

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