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

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
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”

- Micro-loans
- Businesses for the disabled
- Employment training for the unemployed

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

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
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 just review their objects/purposes in their constating 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
- 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

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
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

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 activates that relieve unemployment are:
  - Employment related training
  - Career counseling
  - Establishing lists of available jobs

- 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
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.

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.

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”
1. Individual Development Accounts (IDAs)
   - IDAs are savings accounts 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.

   *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.*

---

- 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.
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.

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.

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.
• 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

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

• 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
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.

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.

   ![Diagram of Charity, 3rd Party, Eligible Beneficiaries]

   (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%.
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

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

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
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.

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.

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.
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.

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

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
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).

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.
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.

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.

Disclaimer

This handout is provided as an information service by Carters Professional Corporation. It is current only as of the date of the handout and does not reflect subsequent changes in the law. This handout is distributed with the understanding that it does not constitute legal advice or establish a solicitor/client relationship by way of any information contained herein. The contents are intended for general information purposes only and under no circumstances can be relied upon for legal decision-making. Readers are advised to consult with a qualified lawyer and obtain a written opinion concerning the specifics of their particular situation.

© 2012 Carters Professional Corporation