
22ND ANNUAL CHURCH & CHARITY LAW SEMINAR

Mississauga – November 12, 2015

Going into Business? Social Enterprise for Churches and Charities

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OVERVIEW OF TOPICS


- Why “Going into Business” matters for Churches and Charities
- The Social Enterprise Paradigm
- Understanding What “Business” Means in a Charitable Context
- Business Sources of Income Generation
- Other Sources of Income Generation

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**A. WHY “GOING INTO BUSINESS” MATTERS FOR
CHURCHES AND CHARITIES**


- Many charities, including churches, will at one time or another look for other sources of income to supplement donations
- Charities, though, generally want their income-producing programs and activities to be tied to achieving their charitable purposes
- In essence, charities want to feel good when they are seeking to “make a dollar”



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- In this regard, many charities may think in terms of undertaking a “social enterprise” when they think of embarking on a business activity to generate income
- However, there is much confusion about what constitutes a “social enterprise” and what types of business activities charities are allowed to become involved with
- This presentation will provide an explanation and provide some thoughts concerning both



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B. THE “SOCIAL ENTERPRISE” PARADIGM

- In its most basic form, “social enterprise” can be boiled down to mean:
 - a business dedicated to achieve a social mission, or
 - making a profit to achieve a social good
- A “social enterprise” is not expected to provide a significant return to its investors since the focus is on achieving a social good instead of a profit
- Social enterprises combine charitable missions, corporate methods, and social consciousness in ways that transcend traditional business and philanthropy

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- The ongoing public interest in “social enterprise” in Canada is reflected in the introduction of new provincial social enterprise legislation:
 - B.C. - Community Contribution Companies
 - Nova Scotia - Community Interest Companies
 - Ontario is now looking at the possible introduction of dual purpose legislation as well
- However, provincial social enterprise corporations are still taxable companies with no general tax incentives available for investors who make contributions of capital or loans to these corporations



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- Charities, on the other hand, enjoy tax advantages in being exempt from tax and issuing tax receipts
- This is because charities provide a public benefit in pursuing their charitable purpose
- The conundrum for charities is to determine what they can do to fulfill their charitable purpose through "social enterprise" while still being compliant as a registered charity under the *Income Tax Act* (ITA)
- In order to address this conundrum, it is important to understand:
 - what "business" means in a charitable context, and
 - what business and other income-generating activities charities are able to be involved with?

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C. UNDERSTANDING WHAT "BUSINESS" MEANS IN A CHARITABLE CONTEXT

- At common law, as reinforced by the ITA, charities must have exclusively charitable purposes
- CRA states that running a business for a charity cannot become a purpose in its own right - it must remain subordinated to the organization's charitable purpose
- Under the ITA, registered charities can lose their charitable registration if they carry on an "unrelated business" i.e. a business that is not a "related business" as explained below

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- By implication, with the exception of private foundations, charities can carry on "related business" activities, as explained below
- It is first necessary, though, to understand what is and what is not considered a "business activity" in a charitable context
- CRA Policy Statement on Related Business Activities (CPS-019) defines "business" as a "commercial activity deriving revenues from providing goods or services, undertaken with the intention to earn profit"



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- Factors identified by CRA in determining whether an activity is a "business" include:
 - Whether the rationale for operating an activity is to generate a profit
 - Whether the activity is structured so that it is capable of earning a profit
 - Whether the activity earned a profit in the past
 - Whether the person or organization that is undertaking the activity has been selected for the position because of commercial knowledge, skill, or experience



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- Examples by CRA of income-generating activities that are not considered to be a business:
 - Soliciting donations
 - Selling donated property, if not done continuously
 - Charging fees in providing charitable programs, such as rent from low-income housing programs
 - Community economic development programs e.g. training businesses, social businesses to address the needs of the disabled, and micro-enterprises



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- Examples identified by CRA of indicators that an income generating activity is not a business:
 - The fee structure is designated to defray the costs of the program rather than to generate a profit
 - The program does not offer services comparable to those otherwise available in the marketplace
 - The fees are set according to a charitable objective as opposed to a market objective, e.g. setting rent in accordance with the user's means
- CRA advises that a charity may engage in occasional business activities as long as such activities are not operated regularly or continuously

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- Examples of activities that CRA generally does not consider to constitute the “carrying on” of a business:
 - Fundraising and sponsorship
 - Passive investments
- Based upon these factors, it is evident that there are income-generating opportunities for charities that involve business activities and some that do not
- The next section of this presentation looks at business sources of income generation, as well as other sources of income generation that collectively make up the “social enterprise” spectrum for charities

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The Social Enterprise Spectrum for Charities

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D. BUSINESS SOURCES OF INCOME GENERATION

1. “Related Business” Income

- The ITA permits charitable organizations and public foundations to carry on “related businesses” as described below
- However, private foundations cannot carry on any form of “related business” activities
- With a “related business” there is no requirement that the charity price the product or service on a cost recovery basis so it is permissible to make a profit

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- Non-compliance resulting from engaging in businesses that are not “related business” could involve:
 - Penalty of 5% of gross revenue from the activity on first offence
 - Repeat offence in 5 years: 100% penalty and suspension of receiving privileges
 - Revocation of charitable status
- A “related business” as defined under the ITA is a business that is either:
 - Substantially run by volunteers (90%); or
 - Linked and subordinate to a charity’s purpose

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(a) “Related Business” Substantially Run by Volunteers

- “Related business” is defined in the ITA to include a business that is unrelated to the objects of the charity, provided that it is run substantially (90%) by volunteers
 - The 90% volunteer determination is to be based on a head count calculation as opposed to a time equivalent
 - e.g. calculation is based on the number of people the charity uses to operate the business as opposed to the number of hours worked
 - A business run by 90% volunteers can be unrelated to the charitable purpose and focus on profit (like a PEI church lobster dinner)

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(b) “Related Business” that is Linked and Subordinate to Charitable Purposes

- Four forms of linkage identified by CRA:
 - A usual and necessary concomitant of charitable programs
 - Business activities that supplement a charity’s charitable programs
 - e.g. hospital parking lots, cafeterias, gift shops, university book stores, student residences

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- An off-shoot of a charitable program
 - Charity may create an asset it can exploit in a business in the ordinary operation of charitable programs
 - e.g. church selling recordings of special Christmas services hosted by its famous choir
- A use of excess capacity
 - Earn income during the periods when assets and staff are not being used to full capacity
 - e.g. university renting out residence facilities in summer months



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- Sale of items that promote the charity or its objects
 - Involves sales that are intended to advertise, promote, or symbolize the charity or its objects
 - Product may serve promotional purpose by virtue of design, packaging, or included materials
 - e.g. sale of pens, credit cards, and cookies that clearly display the charity's name or logo, and T-shirts or posters



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- Factors CRA says indicate subordination to a charity's purpose:
 - The business activity receives a minor portion of the charity's attention and resources
 - The business is integrated into the charity's operation (not acting as a self-contained unit)
 - The charity's charitable goals continue to dominate its decision-making
 - The charity continues to operate for an exclusively charitable purpose by, among other things, permitting no element of private benefit to enter into its operations

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2. Separate "Unrelated Business" Income Through a For-Profit Subsidiary


- In order to avoid a charity carrying on an "unrelated business" and possible penalties and revocation, a charity might consider incorporating a for-profit share capital corporation to act as an intermediary in order to operate the "unrelated business"
- A subsidiary corporation would also be effective in containing liability within the for-profit corporation
- However, in doing so, there are a number of factors that will need to be considered:

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(a) Tax liability under ITA

- Tax would have to be paid on taxable income (but may claim a deduction for donations up to 75% of the company's net income)
- Management service fees and sponsorship fees may be charged by the charity to reduce taxable net income
- Actual tax on placing "unrelated business" activity in a for-profit subsidiary may be as low as 4% to 6% in some instances, depending on the circumstances




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(b) Charity Owning an Interest in a Business

- Having a charity acquire an interest in a for-profit corporation used to be severely restricted because of the *Charitable Gifts Act* before it was repealed in 2009
- Now the issue is whether owning an interest in a for-profit corporation is a prudent investment under the *Trustee Act*



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(c) Restrictions on Foundations Owning a For-Profit Business Corporation:


- Public and private foundations cannot acquire more than 50% of a corporation's issued share capital with full voting rights
- However, shares may be gifted to a foundation (regardless of the percentage) as long as the foundation does not acquire more than 5% of the shares for consideration
- Private foundations are subject to excess corporate holding rules requiring public disclosure over 2% and divestment requirements over 20%

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E. OTHER SOURCES OF INCOME GENERATION

- The following are examples of other sources of income generation within a charitable context that will constitute a form of "social enterprise" e.g. "making a profit to advance a social good"
- With income generating charitable programs described below (but not other sources of income), such activities would help meet the 3.5% disbursement quota of the charity
- See CRA Guidance (CG-014) on Community Economic Development Activities (CED Guidance) for details



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1. Examples of Income Generating Charitable Programs


(a) Businesses for the Disabled

- CRA explains in its CED Guidance that the definition of "disability" means a previous or existing mental or physical disability, and includes disfigurements and previous or existing dependence on alcohol and drugs
- Social businesses involving individuals with disabilities seek to provide permanent employment, not simply on-the-job training or other limited time employment

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- Social businesses may provide services, sell goods, manufacture articles, operate retail outlets or undertake other kinds of work
- Social businesses may directly employ eligible beneficiaries and may provide technical assistance and materials to them
- CRA does not prohibit a social business from earning a profit, so long as the focus is on helping eligible beneficiaries




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(b) Employment Related Training for the Unemployed


- The CED Guidance (CG-014) provides that employment-related training activities that relieve unemployment can be charitable provided the beneficiary group consists of individuals who are:
 - 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 employment-related training include:
 - Employability training: developing employment skills such as English and French language instruction, or life skills, such as time management
 - Entrepreneurial training: Providing instruction on preparing a business plan, preparing financial statements, etc.
 - On-the-job training: providing on-the-job training in vocational or work skills that enhance employability
- CRA permits charities to generate incidental profits from the program, but profit generation cannot be the focus



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(c) Low Rent Housing


- CRA in its Guidance on Housing and Charitable Registration (CG-022) explains that providing low income rental housing can be charitable if it relieves poverty or assists in managing conditions associated with disability or age
- To do so, the charity must assess eligibility of its beneficiaries at least annually (based on their income, assets and liabilities)
- If beneficiaries are ineligible, the rent must either:
 - qualify as investment property generating a fair market value return, or
 - meet the “related business” provisions of the ITA

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(d) Sales of Goods and Services


- CRA in its Guidance on Fundraising (CG-013) states that the sale of goods and services will be seen as charitable if:
 - it serves the charity's beneficiaries
 - directly furthers a charitable purpose, and
 - they are sold on a cost-recovery basis
- For example, university tuition, sale of religious literature by a church, and tickets sold by a symphony



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2. Micro-loans and Loan Guarantees




- The CED Guidance (CG-014) expands the ability of charities to provide loans to achieve a charitable purpose, 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

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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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3. Program-related Investments (PRIs)

(a) 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 return of capital, 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
- Charities are also now allowed to conduct PRIs with non-qualified donees (i.e. non-charities)

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(b) Types of PRIs

- Loans and loan guarantees - to another organization to allow the other organization to achieve the charitable purpose of the investor charity, e.g. making a loan to a third party so that the third party can 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 - 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%, under the excess corporate holding regime




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(c) 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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