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– SPRING 2016
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**GOING INTO BUSINESS?
THE SOCIAL ENTERPRISE
SPECTRUM FOR CHARITIES**

By Terrance S. Carter, B.A., LL.B., TEP, Trade-mark Agent

tcarter@carters.ca
1-877-942-0001

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|  <p>BARRISTERS SOLICITORS TRADEMARK AGENTS</p> | <h2>Carters Webinar Series – Spring 2016</h2> <p>April 21, 2016 1:00pm</p> |
| <h3>Going into Business? The Social Enterprise Spectrum for Charities</h3> <p>By Terrance S. Carter, B.A. LL.B., TEP, Trade-mark Agent tcarter@carters.ca 1-877-942-0001</p> <p>© 2016 Carters Professional Corporation</p> | |
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| <h2>Going into Business? The Social Enterprise Spectrum for Charities</h2> | |
|  | <p>Terrance S. Carter, B.A., LL.B., TEP, Trade-mark Agent – Managing Partner of Carters, Mr. Carter practices in the area of charity and not-for-profit law, and is counsel to Fasken Martineau on charitable matters. Mr. Carter is a co-author of Corporate and Practice Manual for Charitable and Not-for-Profit Corporations (Carswell), a co-editor of Charities Legislation and Commentary (LexisNexis Butterworths), and co-author of Branding and Copyright for Charities and Non-Profit Organizations (LexisNexis Butterworths). He is recognized as a leading expert by Lexpert and The Best Lawyers in Canada, and is a Past Chair of the Canadian Bar Association and Ontario Bar Association Charities and Not-for-Profit Law Sections. He is editor of www.charitylaw.ca, www.churchlaw.ca and www.antiterrorismlaw.ca.</p> |
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OVERVIEW OF TOPICS

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




A. WHY “GOING INTO BUSINESS” MATTERS FOR CHARITIES

- Many charities will, at one time or another, look for other sources of income to supplement fundraising and/ or sponsorship income
- Charities, though, will 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 can become involved with
- The “devil is in the details” applies to this topic



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B. THE “SOCIAL ENTERPRISE” PARADIGM FOR CHARITIES

- In its most basic form “social enterprise” can be boiled down to mean:
 - a business dedicated to achieving 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 looking at the possibility of dual purpose legislation
- However, social enterprise corporations are taxable companies with no tax incentives available for investors



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- Charities, though, enjoy tax advantages in being exempt and can issue tax receipts
- Charities provide a public benefit in pursuing their charitable purposes
- The conundrum for charities is to be able to fulfill their charitable purposes through “social enterprise” while still being compliant with the *Income Tax Act* (ITA)
- It is therefore important to understand:
 - what “business” means in a charitable context; and
 - what business and other income-generating activities charities can and cannot 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 subordinate 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 defined under the ITA

- With the exception of private foundations, charities can carry on “related business” activities as explained below
- It is first necessary although, to understand what is 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”





- 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; and/ or
 - Whether the person or organization undertaking the activity has been selected because of commercial knowledge, skill, or experience



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

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- CRA examples of indicators that income generating activity is not a business:
 - The fee structure is to defray costs of the program rather than to make a profit;
 - The program does not offer services comparable to those in the marketplace; and
 - The fees are set according to charitable objectives as opposed to market objectives, e.g. rent reflecting tenants' financial means



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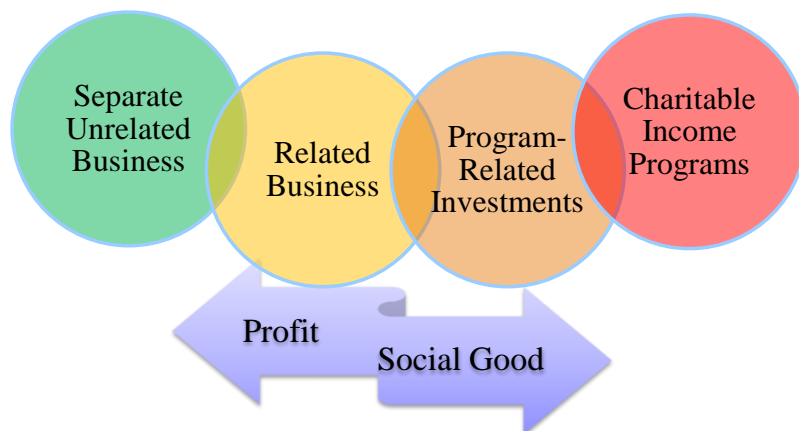
- CRA considers that a charity may engage in occasional “business-like activities”, provided they are not operated regularly or continuously
 - However, this is a grey area of the law
 - For instance, a one time sponsorship would generally not be considered to represent “carrying on” a business
 - However, making sales and providing services on a regular basis requiring ongoing “care and attention” would likely be seen as “carrying on” a business

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- Examples of activities not considered by CRA to constitute “carrying on” of a business:
 - Most fundraising events that have a beginning and an end; and
 - Passive investments deriving from the mere ownership of assets
- It is apparent that there are income generating opportunities for charities that involve business activities and those that do not
- Therefore, need to look at business sources of income generation, as well as charitable sources of income generation that make up the “social enterprise” spectrum for charities

The Social Enterprise Spectrum for Charities



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 business activities (“related” or otherwise)
- 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



- Non-compliance resulting from engaging in businesses that are not a “related business” can result in:
 - Penalty of 5% of gross revenue from the activity on first offence;
 - Repeat offence in 5 years: 100% penalty and suspension of receipting; and/ or
 - 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

(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
 - 90% volunteer determination is based on a head count as opposed to a time equivalent calculation
 - e.g. calculation is based on the number of people used to operate the business, not the number of hours worked
 - A business run by 90% volunteers can be unrelated to the charitable purpose and focus on profit (like PEI church lobster dinners)



(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; and
 - Earns 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 that indicate subordination to the charitable purpose:
 - The business 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; or
 - The charity continues to operate for an exclusively charitable purpose by permitting no element of undue private benefit to enter into its operations



2. “Unrelated Business” Income Through a For-Profit Subsidiary

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

(a) Tax Liability Under ITA

- Tax would have to be paid on income (but may claim a deduction for donations up to 75% of net income)
- As well, management service fees and sponsorship fees may be charged by the charity to reduce taxable net income of the for-profit subsidiary
- Resulting tax consequences of placing “unrelated business” activity in a for-profit subsidiary might be as low as 4% to 6% in some instances, depending on the circumstances



(b) Charity Owning an Interest in a Business

- Having a charity acquire a 100% interest in a for-profit corporation was previously prohibited by the *Charitable Gifts Act* before it was repealed in 2009
- The issue to look at now is whether owning an interest in a for-profit corporation constitutes a prudent investment under the *Trustee Act*



- (c) Restrictions on Foundations Owning a For-Profit Business Corporation
- Public and private foundations cannot acquire more than 50% of 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%

3. “Unrelated Business” Income Through a NPO?

- Is it possible to run an “unrelated business” through a not-for-profit corporation that claims status as a non-profit organization (NPO) under the ITA?
- The answer is generally no, because a NPO must be organized and operated for any purpose other than for profit
- While incidental or unanticipated profit may be possible, a motivation to earn a profit is not an option for a NPO

E. CHARITABLE SOURCES OF INCOME GENERATION



- The following are examples of charitable sources of income generation options for a charity that constitute a form of “social enterprise”, e.g. “making a profit to advance a social good”
- Income generating charitable programs described below would meet the 3.5% disbursement quota of the charity, but the program related investments and loans would not
- See CRA Guidance (CG-014) on Community Economic Development Activities (CED Guidance) for details

1. Examples of Income Generating Charitable Programs

- (a) Social 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 those with disabilities seek to provide permanent employment, not simply on-the-job training or limited time employment

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- Social businesses for the disabled may provide services, sell goods, manufacture articles, operate retail outlets or undertake other kinds of work
- Social businesses for the disabled must employ only individuals with disabilities, except for training staff and supervisors
- Work must match the special needs of the disabled and to relieve conditions associated with the respective disabilities
- 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

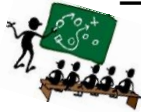
- The CED Guidance provides that employment-related training activities that relieve unemployment can be charitable, provided the beneficiary group consists of individuals who are:
 - unemployed or facing a real prospect of imminent unemployment; and
 - are shown to need assistance (i.e. lack of resources or skills to help themselves)

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- Examples of employment-related training:
 - Employability training: developing 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.; and
 - 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 these programs



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

(d) Sales of Goods and Services

- CRA 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



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 charitable purposes that benefit the community, not just to relieve poverty
- E.g. loan guarantees to help eligible beneficiaries attend courses to enhance their employability or establish a business



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- Providing start-up loans and loan guarantees to establish businesses for an eligible beneficiary can be charitable
 - However, 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 sense because, while PRIs may generate a return of capital, they are not made for that reason
- As such, although permitted 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

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(b) Types of PRIs

- Loans and loan guarantees - to another organization to allow the other organization to pursue 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



- Share purchases - a charity 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



(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; and
 - Evidence of direction and control over PRIs to non-qualified donees



CONCLUSION

- Charities can have an important part to play in the social enterprise conversation
- The key factor to remember is that charities are heavily regulated, so it is essential to understand what charities can and cannot do with regards to social enterprise
- Questions?





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Going Social: Using Social Media to Accomplish Your Mission
 Wednesday, May 4th - 1:00 - 2:00 pm ET
By Sepal Bonni, B.Sc., M.Sc., J.D., Trade-mark Agent
 Counsel on legal issues involving charities and not-for profit organizations in the areas of intellectual property and privacy law. Carters, Ottawa, Ontario.



Human Rights Challenges in the Workplace
 Wednesday, May 18th - 1:00 - 2:00 pm ET
By Barry W. Kwasniewski, B.B.A., LL.B.
 Counsel on legal issues involving charities and not-for-profit organizations with expertise in employment, human rights and insurance law. Carters, Ottawa, Ontario.



The ABC's of GST/HST for Charities & NPOs
 Wednesday, June 8th - 1:00 - 2:00 pm ET
By Linsey E.C. Rains, B.A., J.D.
 Speaker and counsel on legal issues involving charities and not-for-profit organizations. Formerly with Canada Revenue Agency. Carters, Ottawa, Ontario.

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