
RECENT LEGISLATIVE CHANGES MAY FACILITATE IMPACT INVESTING BY CHARITIES

By Terrance S. Carter, Jacqueline M. Demczur & Lynne Westerhof

A. INTRODUCTION

With the introduction of “qualifying disbursements” in the *Income Tax Act*¹ (“ITA”) on June 23, 2022 in Bill C-19, *Budget Implementation Act, 2022, No. 1*² (“BIA”), along with other changes concerning which charitable activities will satisfy the disbursement quota (“DQ”) obligation, it may now be possible for impact investments to be considered as “qualifying disbursements” and thereby be counted towards meeting a charity’s DQ obligations. As background, the DQ is the minimum amount that a charity must spend on its charitable activities or in making qualifying disbursements (including gifts to qualified donees) and is calculated based on the assets owned by the charity in the preceding 24 months that is not used directly in charitable activities or administration. Given the proposed changes in draft legislation released on August 9, 2022 (“Draft Legislation”) to increase charities’ DQ obligations to 5% on investment property in excess of \$1 million,³ it will become increasingly important that the Canada Revenue Agency (“CRA”) recognise impact investing as a qualifying disbursement for purposes of charities being able to meet their DQ obligations each year.

*

Terrance S. Carter, B.A., LL.B., TEP, Trademark Agent, is the managing partner of Carters Professional Corporation and counsel to Fasken on charitable matters. Jacqueline M. Demczur, B.A., LL.B., is a partner practicing charity and not-for-profit law. Lynne Westerhof, B.A., J.D., is an associate practicing charity and not-for-profit law.

¹ *Income Tax Act* (R.S.C., 1985, c. 1 (5th Supp.)) [ITA].

² 1st Sess, 44th Parl, 2022 (received royal assent 23 June 2022).

³ Terrance S. Carter, Theresa L.M. Man and Jacqueline M. Demczur, “Draft Budget Implementation Legislation Will Increase DQ and Affect Trust Reporting” *Charity & NFP Law Bulletin No. 515* (24 August 2022), online (pdf): *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2022/chylb515.pdf>>.

B. CONTEXT OF IMPACT INVESTING IN CANADA

While many charities in Canada are becoming interested in impact investing, they may be reluctant to engage in such investing because of legislative and regulatory challenges that impede their ability to do so.⁴ In general terms, impact investing involves a charity pursuing its charitable purpose by making a dual-purpose investment where achieving its charitable purpose, rather than a return on investment, is the primary focus. While some of the challenges faced by charities wanting to engage in impact investing are matters of provincial law (such as the rules regarding “social investments”⁵ under the *Charities Accounting Act* in Ontario), the primary obstacle at a federal level has been the CRA’s refusal to fully recognize impact investments (referred to as Program Related Investments or “PRIs”⁶) as a charitable disbursement for the purpose of meeting a charity’s DQ. The only exceptions to this are where there is a loss by the charity on the investment or if there is a lower return on investment than the market rate and the charity has otherwise been unable to meet its DQ obligation.

PRIs can include, for example, loans, loan guarantees, leases of land or buildings, and share purchases that facilitate a charity pursuing one or more of its charitable purposes. Since PRIs are not counted towards meeting a charity’s DQ obligation, subject to the above limited exceptions, charities with large investment assets, particularly foundations, have been disincentivized from engaging in PRIs.

C. QUALIFYING DISBURSEMENTS NOW SATISFY A CHARITY’S DQ OBLIGATION

With the introduction of “qualifying disbursements” in the ITA,⁷ the landscape in which charities can expend funds and other resources has changed. A charity can now make a “qualifying disbursement” by way of “a gift or by otherwise making resources available” to a qualified donee or to an organization that

⁴ For more information about impact investing in Canada, see Terrance S. Carter, “Impact Investing by Charities: The New Frontier in Philanthropy” *CAGP 28th National Conference* (15 June 2022), online (pdf): *Carters Professional Corporation* <<https://www.carters.ca/pub/seminar/charity/2022/Impact-Investing-for-Charities-TCarter-2022-06-15.pdf>>.

⁵ See Terrance S. Carter, “The Investment Spectrum for Charities, Including Social Investments” (6 February 2018), *Ontario Bar Association’s Institute 2018, Critical Developments in Charity and Not-for-Profit Law*, online (pdf):

<<https://www.carters.ca/pub/seminar/charity/2018/oba/OBA%20Paper%20Investment%20Spectrum.pdf>>. See also, Terrance S. Carter and Luis R. Chacin, Guidance on Social Investments Released by the Ontario PGT” *Charity & NFP Law Bulletin No. 426* (30 August 2018), online (pdf): *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2018/chylb426.pdf>>.

⁶ Canadian Revenue Agency, “Community Economic Development Activities and Charitable Registration” (26 July 2012; Revised 9 August 2017), online: Government of Canada <<https://www.canada.ca/en/revenue-agency/services/charities-giving/charities/policies-guidance/community-economic-development-activities-charitable-registration-014.html#toc7>>.

⁷ As reported on in Terrance S. Carter & Theresa L.M. Man, “Bill C-19 Budget Implementation Act, 2022, No. 1 Proposes Major Changes To Legislative Framework Governing Charities” *Charity & NFP Law Bulletin No. 511* (25 May 2022), online (pdf): *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2022/chylb511.pdf>> and Terrance S. Carter & Theresa L.M. Man, “Bill C-19 Is Amended To Simplify Funding Of Non-Qualified Donees” *Charity & NFP Law Bulletin No. 513* (28 June 2022), online (pdf): *Carters Professional Corporation* <<https://www.carters.ca/pub/bulletin/charity/2022/chylb513.pdf>>.

is not a qualified donee, referred to as a “grantee organization”, if the qualifying disbursement is made in furtherance of the charity’s charitable purpose.⁸ The reference to “otherwise making resources available” in the definition of “qualifying disbursement” is arguably broad enough to now potentially include impact investing, *i.e.* a charity “otherwise making resources available” to a grantee organisation in the form of an impact investment in order to achieve one or more of its charitable purposes.

The BIA also introduced changes to the ITA providing that gifts that are qualifying disbursements will satisfy a charity’s DQ obligation. Specifically, paragraph 149.1(2)(b) of the ITA says that the Minister of National Revenue may revoke the charitable status of a charitable organization where the organization “fails to expend in any taxation year, on charitable activities carried on by it and by way of gifts made by it that are qualifying disbursements, amounts the total of which is at least equal to the organization’s disbursement quota for that year” [emphasis added].⁹ There are similar provisions which apply to public foundations and private foundations at paragraphs 149.1(3)(b) and (4)(b) of the ITA respectively. If a charity’s PRIs as a form of impact investing are acknowledged by the CRA as constituting qualifying disbursements, then paragraph 149.1(2)(b) of the ITA would mean that such impact investments should be fully counted towards that charity’s DQ obligation. Hopefully the CRA will adopt this approach when its much-anticipated guidance on the new qualifying disbursements regime is released later this fall.

It should be noted that the language in the ITA at paragraphs 149.1(2)(b), (3)(b), and (4)(b) could be more precise on this issue. Where these provisions say that qualifying disbursements will satisfy a charity’s DQ obligation, the specific reference is to “gifts made by [a charity] that are qualifying disbursements” [emphasis added]. The reference to “gifts” leaves open the question of whether PRIs can actually count towards a charity’s DQ obligation, given that PRIs involve investments rather than actual “gifts”. It would be beneficial if the ITA was clarified in this regard by deleting the word “gift” in paragraphs 149.1(2)(b), 3(b), and 4(b) and replacing it with the word “disbursement” in order to make clear that any disbursements that are “qualifying disbursements” (such as PRIs) satisfy a charity’s DQ obligation. This clarification could be included in the Draft Legislation when it is introduced as *Budget Implementation Act, 2022, No. 2* sometime this fall. Alternatively, when the CRA issues its guidance relating to qualifying disbursements,

⁸ *Income Tax Act*, RSC 1985, c 1 (5th Supp), subsection 149.1(1) provides definitions of “grantee organization” and “qualifying disbursement”.

⁹ ITA, *supra* note 1 at subsection 149.1(2)(b).

the CRA could use that opportunity to clarify that PRIs and other types of impact investments are indeed qualifying disbursements that fully count toward meeting a charity's DQ requirements.

D. CONCLUSION

Given these recent changes in the ITA and the increased interest in impact investing in the charitable sector,¹⁰ it is hoped that Canadian charities interested in making PRIs will soon be able to count them towards meeting their DQ obligations and that the pending guidance from the CRA on qualifying disbursements will clarify and confirm this approach. Many voices in the charitable sector have requested that – in light of upcoming changes to the DQ regime – impact investments should be considered as sufficient to meet a charity's DQ obligations.¹¹ An interpretation by the CRA in its guidance (or, if necessary, amendments to the Draft Legislation to clarify the language used at paragraphs 149.1(2)(b), (3)(b) and (4)(b) of the Act) that facilitates and encourages impact investing would be a positive response to calls from the charitable sector on this critical issue. As well, and more importantly, to do so would result in billions of dollars of investment assets currently held by foundations in Canada being made available through PRIs to help pursue charitable purposes rather than only financial returns.¹²

¹⁰ See Aatif Baskanderi & Ratna Omidvar, "How the Government can do More to Advance Impact Investing in Canada" (7 September 2022), online (pdf): *The Philanthropist* <<https://thephilanthropist.ca/2022/09/how-the-government-can-do-more-to-advance-impact-investing-in-canada/>>; See also Chad Park and Greg Elliott, "It can be Done: Catalyzing Positive Societal Impacts through Foundations' Invested Assets" (26 September 2022), online (pdf): *The Philanthropist* <<https://thephilanthropist.ca/2022/09/it-can-be-done-catalyzing-positive-societal-impacts-through-foundations-invested-assets/>>.

¹¹ See, for example, submissions from the Advisory Committee on the Charitable Sector, the Canadian Bar Association, and the Canadian Association of Gift Planners: Advisory Committee on the Charitable Sector, "Advisory Committee to the Charitable Sector (ACCS) Submission to Finance Canada on Disbursement Quota Reform" (31 August 2022) online: *Government of Canada* <<https://www.carters.ca/pub/article/charity/2021/ACCS-Submission.pdf>>; Elizabeth Moxham, "Re: Charities Consultation – Disbursement Quota" (29 September 2022), online (pdf): *Canadian Bar Association* <<https://www.cba.org/CMSPages/GetFile.aspx?guid=a8cc9301-1546-4097-b9ce-c95dbd4b28fa>>; and Canadian Association of Gift Planners, "Written Submission to the Department of Finance, Consultation: Boosting Charitable Spending in our Communities" (30 September 2022), online (pdf): <https://www.cagp-acpdp.org/sites/default/files/cagp_submission_-_boosting_charitable_spending_in_our_communities_-_sept_2021.pdf>.

¹² See "Budget 2022" (7 April 2022), online: *Government of Canada*: <https://budget.gc.ca/2022/report-rapport/toc-tdm-en.html> at s 8.3. See also "Budget 2021" (19 April 2021), online: *Government of Canada*: <<https://www.budget.gc.ca/2021/report-rapport/toc-tdm-en.html>>.