

## THE OTTAWA REGION 2021 Charity & Not-For-Profit Law Webinar

Thursday, February 11th, 2021

# INCOME GENERATION BY CHARITIES AND NFPs: WHAT'S POSSIBLE AND WHAT'S NOT

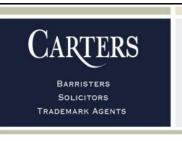
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**The Ottawa Region 2021** Charity & Not-for-Profit Law Webinar February 11, 2021

#### **Income Generation by Charities and NFPs:** What's Possible and What's Not

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**OVERVIEW OF TOPICS** The Importance of Income Generation Income Generation by Charities Income Generation by NFPs **Key Takeaways** www.charitylaw.ca www.carters.ca

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A. THE IMPORTANCE OF INCOME GENERATION

- Given the negative impact of COVID-19 on charities and NFPs, enhancing income generation has become an important topic of discussion
- "NFP" refers to "not-for-profits" and for the purpose of this presentation focuses on "non-profit organizations" (NPOs) under par.149(1)(I) of the *Income Tax Act (ITA)*
- In order to facilitate income generation, it is important to understand what is permissible and what is not
- This presentation does not deal with receipting or HST/GST issues
- As well, given the complexities of the issues, the presentation provides only a general overview
- For specific fact situations, advice should be sought from a qualified professional

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**B. INCOME GENERATION BY CHARITIES** 

1. Income Generation from Gifts

- · What is a gift?
  - Voluntary transfer of property without valuable consideration
  - E.g. cash gifts
  - E.g. gifts of property
- · Gifts from different donors
  - Individuals
  - Corporations and businesses
  - Qualified donees (e.g. public foundations)
- Donation receipts can be issued, subject to splitreceipting rules to determine "eligible amount"

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2. Government Contracts, Grants & Contributions

- Important to review the terms of government contracts
- Contracts must relate to the purpose of the charity
- 3. Income from Charitable Programs/Sale of Goods
- Charities can earn income from their charitable programs and/or sale of goods
- Charging fees for charitable programs and/or the sale of goods will be charitable if the programs or sale of goods:
  - Serves the charity's beneficiaries;
  - Directly furthers a charitable purpose; and
  - Should be reasonable in the circumstances and typically aimed at cost recovery
- See CRA Guidances (CG-013) on Fundraising and (CG-018) on Arts Activities and Charitable Registration, as well as Policy Statement (CPS-024) Meeting the Public Benefit Test, for details

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• Examples of fees for charitable programs and/or sale of goods by a charity that are generally seen as charitable:

- University and college tuition fees
- Hospital health care services
- Symphony ticket sales
- Museum ticket sales
- Counselling fees

- Rent from low income housing
- Fees from long-term care facilities
- Sale of religious literature
- Sale of medical support devices
- If profits occur, charities can keep the profits
- No charitable donation receipts can be issued because value is being received in return

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#### 4. Income from Social Businesses

- Charities can earn income from running a business to provide permanent employment for individuals with disabilities
  - Must employ only individuals with disabilities, except for training staff and supervisors
- Charities can also earn income from employment related training that relieves unemployment
- See CRA Guidance (CG-014) on Community Economic Development (CED) for details

#### 5. Income from Membership Fees

- Charities can earn income from membership fees
- Charitable donation receipts can be issued for the "eligible amount" of membership fees

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6. Income from Conference Fees

- Charities can earn income from conference fees for inperson and virtual conferences tied to their purposes
- No donation receipts can be issued, because value is being received in return

#### 7. Income from Sponsorships

- Charities can earn income from sponsorships provided that they are done on an irregular basis
- No donation receipt can be issued, but businesses can claim a tax deduction for sponsorship, subject to the reasonableness of the expenses claimed

#### 8. Income from Lotteries/Raffles

- Games of chance e.g. bingo, Nevada tickets, etc.
- · No donation receipt can be issued

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9. Income from Fundraising Events

- Galas, dinners, auctions, concerts, golf tournaments
- Crowdfunding campaigns and other online events
- Donation receipts can be issued but are subject to splitreceipting rules in determining "eligible amount"

#### 10. Income from Fundraising by Third Parties

- Charities can earn income from third-party fundraising events, either in person or on the internet, e.g. a P2P campaign
- However, the charity must remain in control of tax receipting and be able to account for all income
- Important to have a written agreement in place with the third party undertaking the fundraising

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#### 11. Income from Passive Investments

- Charities can earn income from passive investments arising from "mere ownership" of property
- Investment income includes interest, dividends, royalties, or rental income involving basic services
- Investments generally must meet the prudent investor standard under the *Trustee Act* (Ont.) or other provinces
- Investment income may also come from "social investments" or "impact investments" where there is a dual purpose of financial return and charitable purpose(s)
  - In Ontario, the requirements for a "social investment" under the Charities Accounting Act may apply
  - "Program Related Investment" (PRI) rules under CRA (CG-014) CED Guidance may also apply

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12. Income from "Related Business"

- CRA permits charitable organizations and public foundations to carry on "related businesses"
- However, private foundations cannot carry on any business activities ("related business" or otherwise)
- With a "related business", there is no requirement that the charity price the sale of products or services on a cost recovery basis
- Non-compliance, though, resulting from engaging in businesses that are not a "related business" can result in penalties and even revocation
- See CRA Policy (CPS-019) What is a Related Business?
- A "related business" 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) 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 done on an annual basis
- E.g. calculation is based on the number of people used to operate the business rather than the number of hours worked
- A business run by 90% volunteers can be unrelated to the charitable purpose (like PEI church lobster dinners)

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b) 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, like a hospital cafeteria
- An off-shoot of a charitable program;
  - Charity may create an asset it can sell in the ordinary operation of charitable programs
- A use of excess capacity;
  - Earns income during the periods when assets and staff are not being used to full capacity
- 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

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c) Factors that indicate subordination to the charitable purpose:

The business receives a <u>minor portion</u> of the charity's attention and resources;

- The business is <u>integrated</u> into the charity's operation (not acting as a self-contained unit);
- The charity's <u>charitable goals</u> continue to <u>dominate</u> its decision-making; or
- The charity continues to operate for an exclusively charitable purpose by permitting <u>no element of</u> <u>undue private benefit</u> to enter into its operations

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## 13. Income from a For-Profit Subsidiary Corporationa) Generally

- In order to avoid a charity carrying on an "unrelated business" with resulting penalties and possible revocation, a charity could consider incorporating a for-profit subsidiary corporation in order to operate an "unrelated business"
- A subsidiary corporation could also be effective in containing liability within the subsidiary corporation
- However, in setting up a subsidiary corporation, there are a number of factors that would need to be carefully considered, including those listed on the next slides:

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- i. Tax Liability Under ITA
  - Tax would have to be paid on income earned but generally may claim a deduction for donations up to 75% of net income
  - As well, some management service fees and sponsorship fees may be charged by the charity to reduce taxable income of the for-profit subsidiary
  - Resulting <u>tax</u> from placing "unrelated business" activity in a for-profit subsidiary may be quite low, depending on the circumstances
- ii. Charity Needs to Receive FMV for the Use of Any of Its Resources
  - The charity cannot simply gift resources to its forprofit subsidiary
  - Instead resources transferred must be done at FMV

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iii. Charity Owning an Interest in a Business

The charity would need to justify the investment of charitable resources as either:

Meeting the prudent investor standard under applicable provincial *Trustee Acts* 

OR

A Program Related Investment under the CRA's CED Guidance, and possibly as a "social investment" in Ontario under the Charities Accounting Act

In Ontario, PGT has the right under the Charities
 Accounting Act to make inquiries where the charity
 owns a "substantial interest" in a business (20%)

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- iv. 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%

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C. INCOME GENERATION BY NFPS

#### 1. Requirements to Be an NPO

- For a NFP to qualify as an NPO under the ITA, an organization must meet all 4 requirements under par. 149(1)(I) of the ITA throughout each taxation year
  - 1. Not be a charity (registered or common law)
  - Be organized exclusively for social welfare, civic improvement, pleasure, recreation or any other purpose except profit
  - 3. Be operated exclusively for social welfare, civic improvement, pleasure, recreation or any other purpose except profit
  - Not distribute or otherwise make available any income for the personal benefit of a member

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 Tax exempt status under par. 149(1)(I) of the ITA is a question of fact that can only be determined after a review of the purposes and activities of the NPO

- CRA is generally of the view that an NPO can engage in income-generating activities and earn a profit, provided that the profit is unanticipated and unintentional
- NPOs can also engage in limited fundraising activities
- NPOs can maintain reasonable operating reserves
- See CRA IT-496R Non-Profit Organizations for historical position on NPOs
- CRA current rules on profit generation by NPOs is in a state of flux as a result of inconsistent CRA rulings and interpretations
- Therefore, difficult to know with any certainty what is acceptable income generation by NPOs and what is not

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### 2. Income Generation Generally Associated with Cost Recovery Activities and/or Reasonable Reserves

- Membership fees
- Sale of goods & services to members tied to the nonprofit purpose of the NPO
- Fees for training courses
- Conference fees
- Sponsorship fees
- Fundraising events
- Investment income from reasonable reserves

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## 3. Income from a For-Profit Subsidiary Corporationa) Generally

- In order for a NFP to avoid carrying on for-profit business activities that could jeopardize its tax exempt status as an NPO, a NFP could consider using a for-profit subsidiary corporation
- CRA has indicated that an NPO can earn income from owning a for-profit subsidiary corporation
- However, the availability of this option depends on the facts of each case
- For instance, an NPO using "excess funds" to purchase shares and/or make loans to a taxable subsidiary may be viewed as having a profit motive, since CRA may see that the NPO has raised more funds than needed to do its non-profit work

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b) Tax Liability

- Tax would have to be paid on the income earned by the subsidiary for-profit corporation
- However, unlike a charity, it is not possible to make a tax deductible donation from the subsidiary corporation to the NPO parent corporation
- Some management service fees, licence fees and sponsorship fees, though, may be charged by the NPO to the for-profit subsidiary to reduce income of the for-profit subsidiary and therefore its net income for tax purposes

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D. KEY TAKEAWAYS

 There are numerous opportunities available for income generation by charities & NFPs

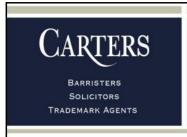
- Charities in particular have a number of options to earn income that may not always be fully understood
- ✓ NFPs have more restricted opportunities to earn income because of the requirement "any purpose other than profit"
- Where a charity or NFP is not able to carry out a type of income generation, then a for-profit subsidiary corporation may be an option to consider
- ✓ The "devil is in the details", so it is important to know the rules

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