



# Carters/Fasken Healthcare Philanthropy: Check-Up 2021

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September 22, 2021

1

## ▲ Agenda

- **Income Generation for Healthcare Charities, including Social Enterprise and Impact Investing** – Terrance Carter
- **Due Diligence: A Necessary Exercise for Charities when Accepting Donations** – Laurie Turner
- **The ONCA and Healthcare Charities: What you need to know** – Theresa Man
- **Data Security, Ransomware and Privacy Law Compliance for Healthcare Charities** – Daniel Fabiano and Daanish Samadmoten

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2

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## Healthcare Philanthropy Check-Up 2021:

September 22, 2021

### Income Generation for Healthcare Charities, including Social Enterprise and Impact Investing

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2

#### OVERVIEW OF TOPICS

Survey of Different Kinds of Income Generation

Income from Related Business

Income from Unrelated Business

Income from Social Enterprises

Income from Impact Investing

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## A. SURVEY OF DIFFERENT KINDS OF INCOME GENERATION

### 1. Government Contracts, Grants & Contributions

- Primary source of income from healthcare charities
- Contracts must relate to the purposes of the charity

### 2. Income Generation from Gifts

- Gifts from different donors
  - Individuals
  - Corporations and businesses
  - Other registered charities, e.g. public foundations
- Donation receipts can be issued subject to split-receipting rules in order to determine the “eligible amount”

### 3. 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 split-receipting rules to determine the “eligible amount”

### 4. 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 pursuant to a written agreement

### 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

## 6. Income from Sponsorships

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

## 7. Income from Lotteries/Raffles

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

## 8. Income from Conference Fees

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

## 9. Income from Passive Investments

- Charities can earn income from passive investments that arise from “mere ownership” of property
- Investment income includes interest, dividends, royalties and rent
- Charities can also invest in limited partnerships as passive investments subject to the rules under the *Income Tax Act* (ITA)

## 10. Income from Charitable Programs/Sale of Goods

- Charities can earn income by charging fees for charitable programs and/or sale of goods, provided that the programs and/or sales:
  - Serve the charity’s beneficiaries;
  - Directly further a charitable purpose; and
  - Fees are reasonable in the circumstances and typically aimed at cost recovery

## 11. Income from Related Business

- Related business income is permitted subject to prescribed rules under the ITA (Details below)

## 12. Income from Unrelated Business

- Unrelated business income is not permitted but can be carried out through a for-profit subsidiary (Details below)

## 13. Income from Social Enterprise

- Social Enterprise income is possible on a limited basis or through a for-profit subsidiary (Details below)

## 14. Income from Impact Investing

- Impact Investing income is possible but is subject to prescribed rules (Details below)

## B. 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

## 1. 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 calculated 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)

## 2. 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

- **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; and
  - The charity continues to operate for an exclusively charitable purpose by permitting no element of undue private benefit to enter into its operations

## C. INCOME FROM UNRELATED BUSINESS

### 1. Utilizing a For-Profit Subsidiary Corporation

- In order to avoid a charity carrying on an unrelated business with resulting penalties and possible revocation, a charity could consider setting up a for-profit subsidiary corporation in order to operate the unrelated business
- A for-profit subsidiary corporation can also be effective in containing potential liability within the subsidiary corporation
- A for-profit subsidiary corporation could also participate in joint business ventures with other for-profit corporations
- However, in setting up a for-profit subsidiary corporation, there are a number of factors that must be considered

- a) 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 of the for-profit subsidiary
  - As well, some management service fees and sponsorship fees may be charged by the charity to the subsidiary to reduce taxable income of the for-profit subsidiary corporation
  - Resulting tax from placing unrelated business activity in a for-profit subsidiary may be quite low in the single digits depending on the circumstances
- b) Charity Needs to Receive FMV for the Use of Any of Its Resources
  - The charity cannot simply gift resources to its for-profit subsidiary, including space, facilities and personnel
  - Instead the resources transferred must be done at FMV

- c) Charity Owning an Interest in a Business
  - The charity would need to justify the investment of charitable resources in the subsidiary as either:

Meeting the prudent investor standard under the *Trustee Act* (Ontario)

OR

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

- In Ontario, the Public Guardian and Trustee has the right under the *Charities Accounting Act* to make inquiries where the charity owns a "substantial interest" in a business e.g. 20%



- d) 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%
- e) Governance and Operational Issues
  - Need a separate board of directors
  - Issues involving cross-over liability need to be considered
  - Subsidiary corporation needs to operate on an arm's length basis with its own bank account, as well as its own books and records

## 2. Brief Reference to Other Business Structures

- a) Non-profit Organizations (NPOs)
  - Utilizing NPOs under par 149(1)(l) of the ITA is a difficult option through which to earn income
  - Definition of an NPO under the ITA and interpretation by the CRA preclude operating a business intended to earn a profit
- b) Business Trusts
  - Business trusts allow distribution of income to the charity tax free
  - However, business trusts are more complicated to set up and operate than a subsidiary corporation

## D. INCOME FROM SOCIAL ENTERPRISES

### 1. What is a Social Enterprise?

- Many charities, including healthcare charities, may be considering starting a social enterprise but are not sure what it involves
- In its most basic form, a “social enterprise” can be described as a revenue-generating business dedicated to achieving a social goal
- A social enterprise is not normally expected to provide a significant return for its investors, since the focus is on achieving a social purpose rather than simply making a profit
- A social enterprise can be undertaken by for-profit corporations, charities, and possibly NPOs to a limited extent

- The ongoing public interest in social enterprise in Canada has been reflected in provincial social enterprise legislation

B.C. Community Contribution Companies (C3s)  
July 29, 2013

Nova Scotia Community Interest Companies (CICs)  
August 2, 2016

B.C. Benefit Companies June 30, 2020

- It is also possible for a for-profit corporation to seek certification as a Certified B Corporation (U.S. designation)

- Any for-profit corporation in Canada (either federally or provincially) can be structured to achieve a social purpose in making a profit through appropriate share attributes and/or unanimous shareholder agreements
- This is because for-profit corporations have a broader mandate at law than simply “shareholder primacy”
- For-profit corporations as social enterprises though, are taxable entities with no resulting tax incentives for investors
- However, charities operating social enterprises are exempt from income tax, can issue charitable receipts for donations, and can receive gifts from other registered charities

## 2. Examples of Social Enterprises by Charities

### a) Social Businesses for Individuals with Disabilities

- Pursuant to CRA’s CED Guidance (CG-014), social businesses by charities include providing permanent employment for those with disabilities, not simply on-the-job training or limited time employment
- Social businesses for the disabled may provide services, sell goods, manufacture articles, operate retail outlets or undertake other kinds of work
- Work must match the special needs of the disabled and relieve conditions associated with the respective disability
- The charity can generate an incidental profit from these programs

## b) Employment-Related Training for the Unemployed

- The CRA 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.* lack of resources or skills to help themselves)
- Examples of employment-related training include employability training, entrepreneurial training and on the job training
- CRA permits charities to generate incidental profits from these programs

## c) Loans and Loan Guarantees

- The CRA CED Guidance (CG-014) permits charities to provide loans to eligible beneficiaries to achieve a charitable purpose, including micro-finance and loan guarantees
- Charities can operate these programs to advance education or other charitable purposes, including health care, that benefit the community, not just to relieve poverty
- *E.g.* loans to help eligible beneficiaries attend courses to enhance their employability or establish a business
- *E.g.* providing start-up loans and loan guarantees to establish a business for an eligible beneficiary to further charitable purposes, but not simply entrepreneurship

## E. INCOME FROM IMPACT INVESTING

### 1. What is Impact Investing?

- Many charities are interested in becoming involved in “impact investing” but are not sure what it involves
- “Impact investing” generally refers to investments made with the intention to achieve a measureable social or environmental impact, as well as a financial return to the investor (e.g. a dual purpose)
- Impact investing is often used interchangeably with “social investing”, “social finance” and “program related investing”
- Social responsible investing (“SRI”) and environmental, social and governance investing (“ESG”) is somewhat different from impact investing in that SRI and ESG investing tend to be more passive strategies for investments in public equities

- Supporters may be interested in making either a loan or a donation to a charity in order to create a “charitable impact investment fund”
- A donation to a charity will result in a donation tax receipt whereas a loan to a charity will not, unless the loan is subsequently forgiven
- Impact investing by a charity can take the form of:
  - A loan (both secure and unsecure)
  - An equity interest (e.g. shares or partnerships interests)
- While impact investing is an important development, it has limitations which the charity needs to be aware of
- The starting point is to understand the different options for impact investing and the applicable regulatory regimes

## 2. “Prudent Investor” form of Impact Investing

- a) Standard of Care
  - *Trustee Act* states a trustee (e.g. a director of a charity) must exercise the care, skill, diligence and judgment that a prudent investor would exercise in making investments
- b) Authorized Investments
  - *Trustee Act* states that a “trustee may invest trust property in any form of property in which a prudent investor might invest”
  - Investment in mutual funds and pooled funds are permitted
- c) Mandatory Investment Criteria
  - *Trustee Act* states that seven mandatory criteria must be considered
    - Includes “assets special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries”
    - Arguable this criteria provides for some scope to make impact investments as part of an investment strategy to pursue financial returns for the charity

- d) Mandatory Diversification Obligation
  - *Trustee Act* requires that trustees must diversify to an extent appropriate to the requirements of the trust and general economic and investment market conditions
- e) Delegation of Investment Decision Making
  - *Trustee Act* permits trustees to delegate investment decision making, but need to comply with prescribed requirements
- f) Prohibition on Sub-delegation
  - *Trustee Act* provides that a delegated investment manager may not further delegate investment decision making
- g) Liability Protection of Trustees
  - *Trustee Act* provides that a trustee will not be liable for losses if the investment decision conformed to an investment plan that a prudent investor would adopt under comparable circumstances

### 3. “Social Investment” form of Impact Investing

- a) Option of “Social Investments” (Dual Purpose) in Ontario
  - In 2017 the *Charities Accounting Act* (CAA) was amended to permit charities in Ontario to make “social investments”
  - “Social investments” involve applying charitable property to both:
    - Directly further the purposes of the charity, and
    - Achieve a “financial return”
  - “Financial return” is defined as an outcome that is better, in financial terms than expending all of the property
- b) Duties of Trustees in Making “Social Investments”
  - Must ensure that social investment is in the interest of the charity
  - Review the investment periodically after making a social investment
  - Both before and after making a social investment, determine whether advice should be obtained (not clear what type of advice is required)

- c) Limitations on Expenditure of Capital
  - Social investments may not be made in relation to trust property that is subject to a limitation on capital expenditure unless trustees expect that the social investment will not contravene that limitation or the terms of the trust to permit such investment
  - Therefore, important to review existing endowment agreements, and endowment templates for future endowment agreements to avoid contravention, as well as possible breach of trust
- d) No Delegation of Power to Make Social Investments
  - Charities may not delegate decision making power with regard to making social investments.
- e) Liability Protection for Trustees
  - Protection of trustees from liability for losses from social investments is limited to only when trustees “acted honestly and in good faith” with the duties, restrictions and limitations that apply under the CAA and terms of trust

## 4. CRA Program Related Investments

- a) What are Program Related Investments (PRIs)?
- Described in the CRA CED Guidance (CG-014)
  - PRIs are defined by the CRA as investments that “directly further” the charitable purposes of the charity
  - A PRI may generate a financial return, though they are not made for that purpose
  - A PRI usually involves the return or potential return of capital but is not mandatory
  - A PRI may also yield revenue, such as interest, but the yield can be below market rates
  - A charity can make a PRI with both “qualified donees”, e.g. other registered charities, but also non qualified donees

- PRIs may overlap with “social investments” in Ontario referenced above
  - As such, social investments may require compliance with the CRA requirements of a PRI (legal advice should be sought)
- Requirements to engage in PRIs
    - Need a policy to describe how PRIs will further the purposes of the charity
    - The charity must maintain “direction and control” over the PRI when engaged in PRIs with non-qualified donees
    - Must ensure that any private benefit is no more than incidental
    - Must prepare and maintain adequate books and records
    - Must have an exit plan



- c) Accounting for PRI
  - PRIs are excluded from the asset base for the calculation of the 3.5 disbursement quota (“DQ”)
  - PRIs, though, are not considered by CRA to be charitable expenditures in meeting the 3.5% DQ except with the loss of capital or lost opportunity costs
- d) What Happens if PRI Requirements No Longer Met?
  - If the requirements for a PRI are no longer met then either exit the PRI or the investment would need to meet prudent investor standards of a regular investment
  - In this regard, it is important to make sure that regular investments are not seen as a business of the charity and/or a “collateral unstated non-charitable purpose”

## 5. Other Factors to Consider when Engaging in Impact Investment

- a) Under the *Income Tax Act*
  - Restrictions on acquisition of control of corporations by public and private foundations (See above)
  - Non-qualified investment rules for private foundations
  - Excess business holding regime for private foundations (See above)
  - Limitations on registered charities investing in limited partnerships
  - Needs to avoid being seen as a related business
- b) Under the *Charities Accounting Act* in Ontario (CAA)
  - 20% “substantial interest” threshold permitting the Public Guardian and Trustee to require financial statements and seek court intervention
  - Commingling of restricted funds rules under CAA regulations

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