COFFEE TALK:
A HEALTH INDUSTRY SEMINAR SERIES

BUSINESS ACTIVITIES AND SOCIAL ENTERPRISE: LEGAL CONSIDERATIONS

Karima Kanani
kkanani@millerrthomson.com
416.595.7908

Andrew Valentine
avalentine@millerrthomson.com
416.595.2980
Agenda

1. What is Social Enterprise?
2. Revenue Generation & Legal Compliance
3. Best Practices for Implementation
4. Questions
What Is Social Enterprise?

- Not a term of art
- Generally, refers to the use of business activities and structures to accomplish a social purpose
- Generates revenue from sale of goods and services
- Can involve private returns to owners/investors
- Can be carried out directly or through a subsidiary
What Is Social Enterprise?

• Vehicles for social enterprise:
  o Registered charity
  o Non-profit organization
  o For-profit organization
  o Hybrid organization
What Is Social Enterprise?

- Ways to generate revenue:
  - Individual and corporate gifts (traditional fundraising)
  - Government funding
  - Grants from foundations
  - Investment income
  - *Programs fees*
  - *Related business activities*

- Last two revenue-generating activities could constitute social enterprise
What Is Social Enterprise?

• Health and social service organizations increasingly looking for new ways of generating revenue

• Examples:
  o Parking
  o Gift shops
  o Food services (e.g. Tim Hortons)
  o Fee-for-service programs
  o Use of facilities/staff when not in use for core activities
  o Development of marketable IP (programs/apps)
Revenue Generation – Legal Compliance

• Our goal is to address two main questions:
  o How are charities permitted to generate revenue (other than grants and gifts)?
  o What rules should you be aware of?
Revenue Generation – Legal Compliance

• The *Income Tax Act* contains rules for registered charities on charitable and business activities

• Failure to follow the rules (for example, carrying on an “unrelated business”) can be grounds for revocation of charitable registration and result in financial penalties
Revenue Generation – Legal Compliance

• Charitable Registration under *Income Tax Act* depends on two criteria:
  
  o must be established for exclusively charitable purposes (look to governing documents)
  
  o must carry out exclusively charitable activities
    
    ▪ concept of “carrying out exclusively charitable activities” allows for revenue generation and certain business activities, within defined rules
Revenue Generation – Legal Compliance

• CRA published policy (CPS-019) identifies indicia of a business activity
  o **The intended course of action**: If the rationale for operating a given activity is to generate a profit, then the activity is likely a business
  o **The potential to show a profit**: Even if an activity does not yield a profit, it may nonetheless be capable of earning a profit. In determining whether a particular activity is a business, it is the intention and capacity to make a profit at some point that are relevant. On the other hand, if the activity is structured so that it is incapable of returning a profit, then it is not a business
  o **The existence of profits in past years**: When the activity has been carried on for some time, a history of it returning a profit would generally imply that a business exists
  o **The expertise and experience of the person or organization that undertakes the activity**: If the person or organization that is undertaking the activity has been selected for the position because of his/her/its commercial knowledge, skill, or experience, it may indicate that the activity is commercial in nature and so may be a business
Revenue Generation – Legal Compliance

- Soliciting donations is not considered to be a business
- Selling donated goods is not considered to be a business
- Occasional fundraising events are not considered to be carrying on a business
- Earning investment income is generally not considered to be carrying on a business
- Fee charging programs that meet certain defined criteria are not considered a business
Revenue Generation – Legal Compliance
Fee Charging

• Indicators that a charitable program involving fees is not a business:
  
  o The fee structure is designed to defray the costs of the program rather than to generate a profit (but may, if appropriate to the overall purposes of the charity, be set at a rate that generate a surplus to help fund the organization’s charitable programs and activities for the benefit of the public)
  
  o The program does not offer services comparable to those otherwise available in the marketplace (sufficient general benefit to the community)
  
  o The fees are set according to a charitable objective as opposed to a market objective, e.g. users' means, promote public health education
Revenue Generation – Legal Compliance
Fee Charging

• CRA has commented specifically on fees in the context of programs by health charities (CG-021):

*A charity can charge fees for health care services or products that directly further promotion of health purposes, as long as this is not done to further a profit purpose. Concerns may also arise if the fees exclude members of the public to the extent that the purpose would not be considered to provide a benefit to the public or a sufficient section of the public. Whether members of the public are excluded from receiving a benefit, and whether an exclusion is to the extent that the purpose does not deliver a public benefit, are questions that will be decided based on the facts in each case.*

• **Key elements:**
  - Health charities can charge fees for health care services/products that further charitable purpose
  - Should not be conducted for a profit purpose
  - Should not unreasonably exclude members of public
Revenue Generation – Legal Compliance Related Business

- The term “related business” is not specifically defined
- CRA Guidance CPS-019 outlines current Charities Directorate view
- What is a related business?
  - A business carried out substantially (90%) by volunteers
  - If not carried out substantially by volunteers → 2 part test
    1. it is a business activity that is both linked to a charity’s purpose and subordinate to that purpose
    2. NOT sufficient to show that the business income is used for charitable purposes
Revenue Generation – Legal Compliance Related Business

• “Linked” to the Charitable Purpose
  o CRA identifies 4 categories of “linkages” between a business and a charity’s purposes
    1. Usual and necessary concomitant of core programs
    2. Offshoot of a charitable program
    3. Use of excess capacity
    4. Sale of item promoting the charity or its objects
1. Usual and necessary concomitant of core programs

- Business activities that supplement core charitable programs
- Necessary for effective operation of programs, or to improve the quality of service

Examples:
- a hospital's parking lots, cafeterias, and gift shops for the use of patients, visitors, and staff
Revenue Generation – Legal Compliance Related Business

2. Offshoot of a Charitable Program

• Exploitation of an asset created incidentally in the course of a charitable program

• Program conducted to achieve charitable purpose, not create asset → asset is a by-product

Examples

• Health charity develops valuable IP (e.g. program know-how) that can be sold to others
Revenue Generation – Legal Compliance Related Business

3. Use of Excess Capacity

- Business that exploits a charity’s assets and staff during periods when not needed for core programs

Examples

- Rental of facilities when not in use for core activities
Revenue Generation – Legal Compliance Related Business

4. Sale of Items that Promote a Charity or its Objects

• Sales that are intended to advertise, promote, or symbolize the charity or its objects

Examples

• Sale of branded merchandise
Revenue Generation – Legal Compliance Related Business

• “Subordinate” to the Charitable Purpose
  o an activity will be considered subordinate if it remains subservient to the dominant charitable purpose
  o how much attention and resources are devoted to the activity?
  o is it integrated into charitable operations or self contained?
  o do charitable goals take precedence?
  o any private benefit?
Best Practices

- For all activities where revenue is to be generated, first analyze how it will be characterized at law and consider risk/impact when structuring the initiative
Best Practices

- Revenue generation decision tree:
  1. Is the activity a business?
     - Intention to profit?
     - Indicators of a business activity?
  2. If yes, does it amount to carrying on a business?
     - Carried on regularly throughout the year?
  3. If yes, is the business a related business?
     - Run by volunteers?
     - Linked and subordinate to charitable purposes?
  4. If yes, charity can carry out the activity directly
  5. If no, could constitute carrying on an unrelated business
Best Practices

• Following implementation monitor revenue generation activities for continued legal compliance
  o Subordination: Monitor resources devoted to the business:
    ▪ Funds
    ▪ Space
    ▪ Staff
    ▪ Time

• No hard and fast resource limit established – fact specific
Best Practices

• Develop internal policies and oversight to standardize assessment of revenue generation initiatives

• Board education on revenue generation legal compliance and enterprise risk
Summary

• The term “Social Enterprise” means many things and is often used in the health and social service sector to refer to revenue generation initiatives.

• Health and social service agencies that are registered charities are subject to legal rules on whether and how they can engage in revenue generation.

• Proactive policies, education and oversight are advisable to ensure risk managed implementation of revenue initiatives.
Questions?

Karima Kanani
kkanani@millerthomson.com
416.595.7908

Andrew Valentine
avalentine@millerthomson.com
416.595.2980