Brief from Philanthropic Foundations Canada
To the Senate Special Committee on the Charitable Sector

September 17, 2018

Proposals to the Special Committee:

a) **Recommend that the Ministers of Finance and Revenue undertake a comprehensive review of the existing regulatory framework for charities in the *Income Tax Act* as recommended by the Consultation Panel on the Political Activities of Charities, and the Co-Creation Steering Group on Social Finance and Social Innovation**

b) **Recommend that the CRA to establish a clear set of guidelines regarding program-related investing (loans to charities and non-profits or below market-rate impact investments by foundations).**

1. Introduction

Philanthropic Foundations Canada (PFC) is a Canada-wide membership association of 135 grantmakers, including private and public foundations and corporate giving programs. Our mission is to promote the growth of effective and responsible foundations and organized philanthropy in Canada. In 2016, the grantmakers we represent contributed **over $641 million in grants and over $382 million in expenditures on charitable programs** to organizations and communities right across Canada.

Charitable foundations are an important source of annual funding to charities, making grants of about **$5.7 billion** in 2016 to Canadian charities, per Canada Revenue Agency (CRA) figures. This philanthropic funding is critical to the work of many charities, even if it is not a large proportion of the annual revenues of most organizations. For large charities, philanthropic funding can be critical to investing in new projects or research. For smaller front-line charities, it can be essential to their ability to hire staff, plan for their future and if the opportunity is there, scale up their impact. We believe that there are opportunities for the federal government through its regulatory framework both to increase the flow of philanthropic capital to Canadian charities and non-profits and to enable charities, including grantmaking charitable foundations, to contribute more effectively to Canada's economy and communities.

2. Creating a Modern Regulatory Framework for the Charitable Sector

What makes a country and its citizens stable and prosperous? It's more than jobs and the production of goods and services. Community prosperity is also about education and training, child care and strong social infrastructure (affordable housing, access to health services, availability of recreation etc). Many of these supports are provided and operated by the charitable and nonprofit sector. And many organizations in this sector have front line experience and policy capacity that they can contribute to public policy makers to make the work of government smarter and more effective.

What might make charities less effective in contributing to community wellbeing? A federal regulatory system that unnecessarily constrains the deployment of capital and prevents effective partnerships within the charitable sector and between the charitable sector and the private and public sectors. Disproportionate reporting requirements, rigid rules governing financial relations between charities and non-charities, rules that discourage charities from advocacy and contributing to better public policy development, and lack of regulatory clarity on the ways in which investment capital can be provided to charities by charitable foundations, all combine to make charities and charitable funders less innovative, less effective and less capable of contributing to our society overall. We would like to see federal regulation and law that encourages rather

than deters legitimate and productive partnerships between charities, businesses and governments.

The federal government has recognized this justifiable need. In 2015, the Prime Minister directed the Ministers of Finance and National Revenue (as well as the Ministers of Justice and of Families, Children and Social Development) to modernize the rules governing the charitable and non-for-profit sectors and to work towards "clarifying the rules governing "political activity," with an understanding that charities make an important contribution to public debate and public policy."

The federal government undertook in 2016 to consult with the charitable sector on the question of political activities. An experienced and expert Consultation Panel on the Political Activities of Charities, appointed by the Minister of National Revenue called in 2017 for changes to the federal framework governing the charitable sector. PFC strongly supported the Panel's recommendations. A recent decision by the Ontario Superior Court referenced these recommendations and struck down the ITA provisions regarding political activities. Following this decision, the federal government stated in August that it would make legislative amendments this fall to implement Recommendation 3 of the Panel report, which was to "amend the ITA by deleting any reference to non-partisan "political activities" to explicitly allow charities to fully engage, without limitation, in non-partisan public policy dialogue and development, provided that it is subordinate to and furthers their charitable purposes."

The Panel also recommended that the government "modernize the legislative framework governing the charitable sector (ITA) to ensure a focus on charitable purposes rather than activities and adopt an inclusive list of acceptable charitable purposes to reflect current social and environmental issues and approaches."

We believe that the time is long overdue for a modernization of the rules that apply to registered charities. The ITA sections respecting charities have ***never*** been thoroughly reviewed and modernized. Today the charitable and non-profit sectors are working more and more with the business sector and with social enterprises to pursue public and community benefit. The regulatory regime for charities does not easily accommodate intersectoral activity or social innovation. To allow charities and foundations to contribute more fully to Canadian communities, we need to modernize the *Income Tax Act's* rules regime as it applies to the regulation of registered charities.

This review could open the door to more effective policy work, more productive partnerships between charities and non-charities, and more deployment of philanthropic capital into the charitable sector. The Social Innovation and Social Finance Strategy Co-Creation Steering Group (of which a Canadian foundation leader was a member) reported at the end of August to Minister Duclos. It also touched on these questions, recommending that "the Government move from a compliance-based approach to

regulating registered charities and non-profit organizations to one that is enabling and adaptive, so that organizations are able to innovate more readily. This new approach will require a paradigm shift, where the Government recognizes charities and non-profits as partners in achieving common objectives and acknowledges that they create value beyond the cost of the tax benefits they receive. Rather than treat charities and non-profits as competitors with the private sector, the Government should embrace the sector as part of an ecosystem of players that together create social and economic value for Canadians."

Going further the Steering Group recommended that "the government should make **it easier for registered charities to innovate in collaboration with non-qualified donees, including non-profits, businesses, and social innovators.** Consider removing the prohibition on making grants to non-qualified donees and clarify the Income Tax Act to enable the Canada Revenue Agency to adopt an expenditure responsibility regime as a mechanism to ensure that the charity's resources are being used in furtherance of its purposes. This modernization of the rules relating to direction and control when carrying out activities with non-qualified donees will enable charities to work more closely with beneficiary groups and open up the rules pertaining to program related investments, which affect charities' ability to invest for both economic and social returns."

PFC fully endorses these recommendations. Their implementation would permit charitable foundations to become much more flexible and capable of deploying capital fully in support of innovative projects and programs in communities across Canada.

3. Expanding Opportunities for Financing The Charitable Sector

Charities and non-profits need access to all forms of capital, whether earned income, loans or investments, since donations and grants together cannot meet all their financing needs. Social innovation and entrepreneurial activity in the non-profit sector is not usually financed from charitable giving. Charitable grants per the *Income Tax Act*, can be made *only* to qualified donees, or charities, regardless of whether a charity and a non-profit share a similar charitable or public benefit purpose. The invested assets of charitable foundations, by contrast, can be made available to businesses and nonprofits such as social enterprises as well as to charities (through loans for example).

Canadian non-profits and charities need more diversified sources of financing to make a greater contribution to community. We believe that this effort should be given a more prominent place in federal strategies for increasing productivity in the social sector as well as in the business sector. The philanthropic sector is very interested in developing the impact investing and debt capital marketplace for charities. Private foundations supported the work of the Canadian Task Force on Social Finance in 2010, contributed to the establishment of the MaRS Centre for Impact Investing in 2011, participated in

the Canadian National Advisory Board to the G8 Social Impact Investing Taskforce in 2014, and in the Social Innovation and Social Finance Strategy Co-Creation Steering Group established by Minister Duclos. This group has examined mechanisms to attract investors and accelerate the growth of intermediaries that act as a bridge between investors and the charitable and non-profit sectors. As mentioned, the steering group has now reported to the Minister and has made several recommendations to update and improve the regulatory framework to permit more social finance activity.

PFC is committed to promoting impact investing with the goal of increasing the availability of charitable resources for charitable and nonprofit organizations that support communities and Canadian workers. We look to the federal government to play its part in addressing legislative and policy barriers to investment in the non-profit and charitable sector.

To create a more encouraging regulatory regime for charitable funders who wish to provide capital in the form of loans and investments in charities and non-profits we suggest that the Committee recommend that:

- The CRA establish a clear set of guidelines regarding **program-related investing** (loans to charities and non-profits or below market-rate impact investments by foundations).

This type of program-related investing or PRI has had little regulatory recognition other than in a CRA policy guidance document on community economic development (CG-014) first published in 1999 and revised in 2012. While the revisions in 2012 were helpful in defining PRIs and in clarifying that foundations can make PRIs even to non-profits (not just charities) if agency rules are followed, the regulations are not entirely clear and their requirements for direction, control and reporting are a disincentive to the use of these mechanisms, especially by smaller foundations. The guidance on PRIs could be set out independently and not embedded in a document on community economic development but established as a tool that can be used for any recognized charitable purpose or, more broadly, for public benefit, pursued by a registered charitable foundation. At present, these rules are overly onerous and restrictive to charities and their agents.

The philanthropic sector wants to work in partnership with the federal government to modernize our regulatory relationship and to develop our capacity to contribute to Canadian community wellbeing and to create a more innovative and just society. These proposals would lead to significant improvement in philanthropy's ability to support Canadian communities.

Thank you for your consideration.