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# COFFEE TALK: A HEALTH INDUSTRY SEMINAR SERIES

## BUSINESS ACTIVITIES AND SOCIAL ENTERPRISE: LEGAL CONSIDERATIONS

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# 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:
  - Registered charity
  - Non-profit organization
  - For-profit organization
  - 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:
  - Parking
  - Gift shops
  - Food services (e.g. Tim Hortons)
  - Fee-for-service programs
  - Use of facilities/staff when not in use for core activities
  - Development of marketable IP (programs/apps)



## Revenue Generation – Legal Compliance

- Our goal is to address two main questions:
  - How are charities permitted to generate revenue (other than grants and gifts)?
  - 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:
  - must be established for exclusively charitable purposes (look to governing documents)
  - 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
  - **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
  - **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
  - **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
  - **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:
  - 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)
  - The program does not offer services comparable to those otherwise available in the marketplace (sufficient general benefit to the community)
  - 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
    - it is a business activity that is both linked to a charity’s purpose and subordinate to that purpose
    - NOT sufficient to show that the business income is used for charitable purposes

# Revenue Generation – Legal Compliance Related Business

- “Linked” to the Charitable Purpose
  - 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



# Revenue Generation – Legal Compliance Related Business

## 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
  - an activity will be considered subordinate if it remains subservient to the dominant charitable purpose
  - how much attention and resources are devoted to the activity?
  - is it integrated into charitable operations or self contained?
  - do charitable goals take precedence?
  - 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
  - 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?

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