Philanthropic foundations Canada
Fondations philanthropiques Canada

Brief from Philanthropic Foundations Canada
To the Standing Committee on Finance
Pre-Budget Consultations

July 2016

Summary of Recommendations:

a) **Clarify the CRA guidance governing program-related investment by foundations**
b) **Create an advisory panel, involving stakeholders from the public, private, non-profit and charitable sectors, to help define a national strategy on the development of the social finance marketplace in Canada.**
c) **Establish a process with participation from the charitable and non-profit sector to review the regulatory regime with respect to the definition of charitable purposes and activities, including advocacy.**
d) **Reinstate the collection of key data on the non-profit sector by Statistics Canada that would enable better policy –making on the regulation and capacity-building of the non-profit sector in Canada**

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1. Introduction

Philanthropic Foundations Canada (PFC) is a Canada-wide membership association of over 130 charitable 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 2014, the grantmakers we represent as members contributed **over $520 million in grants and over $258 million in direct expenditures on charitable programs** to Canadian communities.

Charitable foundations overall are an important source of annual funding to charities. Registered foundation endowment **assets** total about **$61 billion** (as of end 2014 according to the Canada Revenue Agency (CRA). In 2014, they made **grants** in the amount of about **$5 billion** to Canadian charities, again according to CRA figures. By any measure, this flow of capital is an important source of support for Canadian communities, and contributes to the wellbeing and enhanced opportunities for growth of these communities. Nevertheless, even though this funding is substantial, we believe that there are other opportunities to increase the flow of capital to Canadian charities and non-profits in ways that will support their productivity, growth and job creation as well as their impact on communities.

2. Expanding Opportunities for Social Finance

Charities and non-profits need access to debt capital as well as to grants. Credit offered through loans, loan guarantees and direct investments will extend the capital required since donations and grants together cannot meet all of the financing needs of Canadian charities. In particular, social innovation and entrepreneurial activity in the non-profit sector is not typically financed from charitable giving. Grants can only be made to qualified donees, or charities, according to the *Income Tax Act*. 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).

For this reason, the philanthropic sector is very interested in developing the impact investing and debt capital marketplace for charities and nonprofits. Private funders supported the work of the Canadian Task Force on Social Finance in 2010, contributed to the establishment of the MaRS Centre for Impact Investing and supported the work of the National Advisory Board to the G8 Social Impact Investing Taskforce in 2014. To quote from the report of this Advisory Board: “impact investment has the potential to foster innovation in the social sector. It can be used to develop and test new ideas that may effectively tackle social challenges, and to scale up those that work. Impact investment can spur non-profit, private, and public sector collaboration, to assist individuals and communities to realize greater social and economic outcomes."

The charitable sector and charitable investors were very encouraged by the Government's decision to move ahead quickly this spring to legislate a policy change to the rules concerning investments in limited partnerships (LPs) by charities and foundations through an amendment to the *Income Tax Act*. This change should bear fruit in new investments made in the social sector as more initiatives in areas such as social housing and renewable energy development are structured through LPs to attract investors with a social purpose.

To create an even more encouraging regulatory regime for charitable funders who wish to provide more of their capital in the form of loans and investments in charities and non-profits we ask the Committee to make the following recommendations to the Minister of Finance and his colleagues:

- We recommend that the CRA clarify policy on **program-related investing** (loans to charities and non-profits or below market-rate impact investments) by foundations.
- We recommend that the Ministers of Finance and Revenue Canada, in collaboration with the Minister of Families, Children and Social Development, create an **advisory panel**, involving stakeholders from the public, private, non-profit and charitable sectors, to help define a national strategy on the **development of the social finance marketplace** in Canada. This panel should examine the structure and fund sourcing of catalytic capital funds in other jurisdictions and make recommendations with respect to how such a fund might best be established in Canada. By acting as first-loss capital, catalytic funds can attract other investors and accelerate the growth of the sector of intermediaries that act as a bridge between investors and the charitable and non-profit sectors.

Discussion

PFC is committed to working with other philanthropic organizations to promote education and information-sharing on mission and program-related investing with the goal of increasing the availability of charitable resources for the benefit and growth of communities. We look to the federal government to play its part in addressing legislative and policy barriers to social entrepreneurship and impact investment in the non-profit and charitable sector, with a focus on the *Income Tax Act* and associated regulations; and on encouraging more impact investment through "catalytic capital" measures.

Canadian foundations are increasingly interested in vehicles that will allow them to apply more of their capital assets for social purposes. A number have already embarked on impact investments in companies that operate in socially responsible ways (for example have adopted environmental, social and corporate governance policies) or that work directly in fields of interest to the funders such as health care, housing or sustainable development. For example, a private foundation can finance a reduced rate mortgage to an education charity to finish construction of school facilities, or can make a no interest loan to a human services agency to purchase a transitional house, or provide a guarantee to a nonprofit housing corporation that is building new social housing units. Canadian charities continue to have need for such capital, to finance their facilities, bridge finance the acquisition of equipment, invest in "soft" capital such as business plans or human resource development and otherwise finance their growth. This is particularly true for the smaller charities which are not well served by commercial institutions because they tend to have multiple and unpredictable sources of revenue. There is a gap for unsecured debt for working and growth capital in smaller amounts. Loans from foundations can help to bridge this finance gap for small and medium sized charitable organizations. Further federal encouragement of this activity will be of great benefit to many of them without incurring any significant fiscal cost to government.

We propose that the Committee recommend to the Minister of National Revenue that the Charities Directorate clarify the regulatory regime and encourage the practice of program-related investments (PRIs) by foundations. This type of investing (in the form of below market rate loans, loan guarantees or share purchases) 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) as long as 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 more broadly so that it is 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. The requirements for control and reporting should also be reviewed to ensure that they are proportional to the risk incurred and to the capacities of the smaller lenders.

PFC recommends that the Government establish an advisory panel, involving stakeholders from the public, private, non-profit and charitable sectors, to help define a national strategy on the development of the social finance marketplace in Canada. The time is certainly ripe for a national strategy to develop social finance markets in Canada. Canada lags other countries in the G7 in this regard.

The models are there. There has been considerable progress made over the last five years in exploring the potential for social finance and the options for expanding both the supply and the demand side of this market. It is incontrovertible that Canadian non-profits and charities need more diversified sources of financing to make a greater contribution to productivity, job creation and community wellbeing. 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, and that a broad cross-sectoral effort to develop this national strategy should be undertaken. This recommendation is also supported by the MaRS Centre for Impact Investing.

Our recommendations would not incur any major ongoing fiscal cost while stimulating the availability of private capital to charities, expanding the social finance marketplace and promoting innovation, entrepreneurship and productivity for Canadian charities and communities.

3. Creating a More Modern and Solid Foundation for the Charitable Sector

We are encouraged that the Prime Minister directed the Ministers of Finance and National Revenue to allow charities to do their work on behalf of Canadians free from political harassment, and to modernize the rules governing the charitable and non-for-profit sectors. The mandate letters to these Ministers stated that this work "will include clarifying the rules governing "political activity," with an understanding that charities make an important contribution to public debate and public policy." We agree strongly with this latter statement and look forward to participating actively in the CRA consultations promised by the Minister of Finance in the 2016 Budget to clarify what is meant by political activities of charities.

Beyond the issue of political activity, we believe that the time is long overdue for a modernization of the definition of what constitutes charitable purpose and activity. Today the charitable and non-profit sectors are working more and more with the business sector and with social enterprises to pursue objectives for public and community benefit. The regulatory regime for charities does not easily accommodate intersectoral activity or social innovation. To allow charities to contribute more fully and productively to the community, we need to review the *Income Tax Act's* definitions and provisions regarding what is charitable.

To this end, PFC endorses the following recommendation which has wide support in the charitable sector. We ask that:

- the Government move quickly to conduct **a review of the regulatory regime with respect to the definition of charitable purposes and activities, including advocacy, not just political activity**. This review should be conducted in consultation with the charitable and non-profit sector.

We also recommend that

- the Government reinstate the **collection of key data on the nonprofit sector** by Statistics Canada that would enable better policy-making on the regulation and capacity-building of the non-profit sector in Canada.

Both of these recommendations are broadly supported by organizations in the sector and would address concerns that many charities have had with the lack of clarity on the definition of what activities are permitted to charities, and the lack of information on the economic contribution and employment profile of the charitable and non-profit sector. There is widespread agreement that our legislative definitions of charitable activities are seriously out of date and out of step with other common law jurisdictions which have modernized their definitions of charities according to their charitable purposes, not their activities. There is also widespread frustration in the sector over the lack of useful and policy relevant data on the sector. The last systematic census of the charitable and non-profit sector was conducted in 2003, over 13 years ago. The last study of the contribution of the non-profit sector to Canada's economy was done in 2009, over 6 years ago.

The non-profit and charitable sector is a very important contributor to Canadian economic growth and to social well-being. We want to work in partnership with the federal government to modernize our regulatory relationship and to develop our capacity to contribute to better policy development. These recommendations would lead to significant improvement in our ability to do our work on behalf of Canadian communities and to collaborate with government on mutual goals and objectives.

Thank you for your consideration.