Strong Charities. Strong Communities.

Submission to the

Senate Special Committee on the Charitable Sector

September 2018

Recommendations

Recommendation 1: That the Special Committee encourage the federal government to provide Statistics Canada with a clear mandate and the financial resources (estimated at no more than $1 million per year) to collect, analyze, and disseminate data about the social purpose sector.

Recommendation 2: That the Special Committee encourage the federal government to work with the social purpose sector to identify and implement machinery of government changes so that the long-term health and vitality of the sector are an integral part of the federal policy- and decision-making process.

Recommendation 3: That the Special Committee encourage the government to revisit the recommendations of the Independent Blue Ribbon Panel on Grant and Contribution Programs, and ensure government-wide adoption of the Panel's recommendations.

Recommendation 4: That the Special Committee encourage the federal government to reconsider its decision regarding capital gains taxation on donations of real estate and private company assets.

Recommendation 5: That the Special Committee encourage the federal government to launch, in partnership with the social purpose sector, a two-year long co-creation process aimed at modernizing the legal and regulatory regime under which charities and nonprofits operate.

Recommendation 6: That the Special Committee encourage the federal government to work with the sector to prioritize and implement recommendations made by the Social Innovation and Social Finance Strategy Co-creation Steering Group.

Context

The social purpose sector – registered charities, public-benefit nonprofits, and an increasing number of social enterprises – make enormous economic and social contributions to Canada. The data available to us indicate that two million Canadians work in the sector, which accounts for more than 8% of GDP.

There are, however, serious limitations on this data.

With regard to **registered charities**, we can with some confidence refer to approximately 86,000 organizations, as each one must file an annual information and financial return (the T3010 form) with the Canada Revenue Agency. We also have relatively good data about their overall revenues and the donations they receive (whether tax-receipted or not). Employment data is less reliable, and data about self-generated revenue is insufficiently detailed for proper analysis. These are revenues that come from neither government nor donations, but are generated through activities like membership fees, the sale of goods and services, or the operation of related businesses.

Information about **nonprofits** is very sketchy, and largely based on surveys and data generated by Statistics Canada in 2003. Nonprofits may be incorporated at either the federal or the provincial/territorial level. Reporting requirements vary from jurisdiction to jurisdiction. In the case of federally-incorporated nonprofits, not all are required to submit annual financial returns.

Social enterprise itself is not a new phenomenon. Most of us are familiar with things like Salvation Army thrift shops, or the gift shops operated by hospitals or museums. These are examples of social enterprise in action. However, Canada and other countries have seen a rise in for-profit enterprises that have at their core a social purpose and mission. In some jurisdictions, such as British Columbia or Nova Scotia, new corporate structures have been legislated to encompass these. In most of Canada, though, legal definitions have not kept up with developments in the marketplace. While some attempts have been made to quantify social enterprise in Canada, existing data products pre-date the emergence of these enterprises.

While the current federal government has made data – and the collection, analysis, and dissemination thereof – a priority, data about charities, nonprofits, and social enterprises as a whole has not been seen as a priority. Statistics Canada last conducted the National Survey of Nonprofit and Voluntary Organizations (upon which much of our understanding of nonprofits is based) in 2003, and last published the Satellite Account of Nonprofit Institutions and Volunteering (upon which much of our economic understanding of the sector is based) in 2010 (using 2008 data). Neither of these products was considered part of Statistics Canada's core mandate, and both were discontinued when all federal departments and agencies were identifying savings in the aftermath of the 2008 economic crisis.

Statistics Canada has shown an openness to work with the sector to identify data needs and to provide a one-time update to the Satellite Account. (We continue to refer to the 2008 Satellite Account figures, though, as those have been published by Statistics Canada.) However, officials have also indicated that unless the government provides the necessary mandate and resources, they will not be able to commit to regularly producing the data that policy-makers need.

Recommendation 1: That the Special Committee encourage the federal government to provide Statistics Canada with a clear mandate and the financial resources (estimated at no more than $1 million per year) to collect, analyze, and disseminate data about the social purpose sector.

Throughout the remainder of this brief, where figures are cited, we will specify the data source.

A case for urgency

Imagine Canada's Chief Economist has conducted an analysis of long-term trends affecting the sector, and the impact that these trends – be they economic, demographic, or social – are likely to have. His analysis and conclusions were published in late 2016 in a paper entitled *Charities, Sustainable Funding and Smart Growth*.

The Chief Economist's paper introduces a new concept, that of a **social deficit**. Very simply stated, the social deficit is the projected gap between the demands that individuals, communities, and governments place on organizations, and the financial resources needed to meet those demands. Under very realistic assumptions about economics and demographics, this gap could reach $25 billion per year within a decade from today.

The phenomena driving the social deficit will not come as a surprise to policy-makers. Indeed, they are the same issues that governments and private companies face as they ponder their own longer-term strategies.

- Long-term real economic growth is forecast to be much lower in coming years than has been the case for the last several decades.
- An aging population means proportionately fewer economically-active individuals, and increased demand for public pensions and Old Age Security, health care, home care, and other services aimed at seniors such as meals on wheels programs.
- While increased immigration has well-established longer-term economic benefits and will help to offset some demographic shifts, it also means increased demand for services like immigrant settlement, assisted housing, ESL, and job training. The bulk of these services are provided by sector organizations.
- Several of the social challenges we have all faced together for some time now are changing in their nature. For example, the opioid crisis is very different than the types of substance misuse issues we are more used to. These challenges are often multi-faceted, requiring new approaches and new types of partnerships – which we as a society will need to invest in.

The social deficit is unique in that it will not show up on any financial balance sheet. Charities are by and large not allowed to run deficits; even if they could, they do not have access to the sorts of capital that would allow them to finance those deficits. Instead, the social deficit will manifest itself as longer waiting periods for services, or reduced service levels, or through staff and volunteers being asked to devote more time without a commensurate increase in the resources available to them.

There is no simple solution to the social deficit. Governments will not be in a position to make up the shortfall; regardless, we would not expect them to do so. Mitigating the social deficit will require a new approach and a new partnership between all sectors of the economy. The most valuable role that government can play is to work with us to establish the environment, the conditions in which organizations will have the flexibility to use the tools most appropriate to their own circumstances.

A "home" in government

Registered charities are regulated by the Canada Revenue Agency, in its role as guardian of the *Income Tax Act* and because of the benefits that charities derive therefrom. The CRA also plays a role in ensuring that nonprofit corporations (that are not registered charities) fulfil their obligations as such.

We note that the CRA's role with regard to charities and nonprofits is not substantially different than the role it plays enforcing the *Income Tax Act* as it pertains to individuals and private sector organizations. That is, it enforces the rules to maintain the integrity of the tax system.

We do not question this role. We recognize the need for a strong regulator and we believe that the CRA's Charities Directorate carries out its role effectively. Indeed, there is a great deal of expertise within the Charities Directorate of which government as a whole does not avail itself.

What is currently lacking is a federal department, minister, agency, or secretariat with a mandate to steward the interests of the social purpose sector as a whole. We contrast this with other economic sectors – many of which account for a smaller portion of GDP than our sector – like manufacturing, small business, agriculture, forestry, oil and gas, and fisheries. These all have dedicated structures within government with a mandate to promote their overall health.

The lack of a "home" in government manifests itself in two significant ways:

1. To the extent that the government has made public commitments on proactive policy development, it is unclear which department or minister has primary responsibility. For example, the Ministers of Finance, National Revenue, and Justice have all been charged in their mandate letters to move forward on a modernized legal and regulatory regime for charities and nonprofits. It is not clear, though, who actually has overall responsibility for the issue, and to whom sector representatives can best direct their

efforts. Similarly, the Minister of Families, Children and Social Development and the Minister of Employment, Workforce Development and Labour have joint responsibility with regard to developing a social innovation and social finance agenda.

2. When government policies are developed, there is no formal consideration given to any differential effect on charities and nonprofits. There are instances where policies have had negative effects, and we believe this was done inadvertently because policy-makers are not required to explore the effects on charities and nonprofits the way they are required to consider gender, small business, rural vs. urban considerations, official language communities, or Indigenous people and communities. For example, when Canada's Anti-Spam Law was passed, there was an attempt to exempt registered charities' solicitations of donations; however, this is only one component of how charities engage with the public. As a result, many charities have incurred costs that may not have been intended. More recently, there was a great deal of attention paid to the attestation on reproductive rights that applicants for Canada Summer Jobs Program funding are required to make. Charity law actually bars registered charities from making any statements on public policy issues not related to their charitable purpose. Requiring charities to make this attestation that is not related to their purposes (or, in some cases, is arguably contrary to their charitable purpose) is problematic under our understanding of charity law. In order to access a public program, one branch of government is requiring charities to potentially violate a law enforced by another branch of government. This is an untenable situation, and one that we believe could have been easily avoided.

There are numerous examples, domestically and internationally, of how a home in government for the sector could be structured and implemented. Some jurisdictions have ministers and/or departments for the sector. In the UK, the Office for the Third Sector was launched by the Blair government as a secretariat within the Cabinet Office (the UK's equivalent to the Privy Council Office in Canada). Recent years have seen an increasing number of comparator countries, ones that share Canada's common law traditions with regard to charity law, establish independent regulators that also play an enabling policy role. (These countries include the UK, Australia, Ireland, and New Zealand.)

We do not propose a specific model at this time, as we believe a solution is best arrived at by working in partnership with the government to determine what we all believe will work best in the Canadian context.

Recommendation 2: That the Special Committee encourage the federal government to work with the social purpose sector to identify and implement machinery of government changes so that the long-term health and vitality of the sector are an integral part of the federal policy- and decision-making process.

Financial sustainability

Broadly speaking, social purpose organizations rely on three streams of revenue: government grants and contributions, donations, and self-generated income. Because of the data limitations noted above, figures in this section are for registered charities and are based on the complete set of T3010 filings for all registered charities.

The available data indicate that overall 2016 revenues for registered charities totalled approximately $261 billion.

Before considering the source of these revenues, it is worth drawing a distinction between two broad categories of charities. Universities, colleges, school boards, and hospitals form the bulk of what could be referred to as "government-aligned" charities. That is, they are established and regulated as registered charities, but a significant portion of their funding comes as grants from governments to deliver vital public services and governments exercise significant influence over their operation. These organizations account for about $189 billion, or just over 72 percent of total charity revenues. Of the 86,200 charities currently registered, approximately 1,400 fall within this category.

"Unaligned" charities – the ones that members of the public are more likely to think of when they hear the word "charity" – generated roughly $72 billion in revenue, or just under 28 percent of the total. While many of them receive funds from governments, in the form of grants, contributions, or service delivery contracts, they are answerable primarily to community-based volunteer board members.

There are significant differences between the overall revenue composition of these two types of charities.

For government-aligned charities, 80 percent of total revenues come from governments, with two percent generated by fundraising, nine percent from earned income, and the remainder from other revenue streams.

In comparison, non-aligned charities derive 35% of total revenue from governments, 34% from donations, and 22% from earned income.

The challenge for charities, in the face of increased demands and expectations, is to grow revenues where they realistically can.

Revenue from governments

We note above that governments are set to face many of the same challenges as charities and nonprofits. Slower long-term economic growth, an aging population, and increased post-secondary education participation rates will have significant impacts on government revenues and spending priorities. International competition and the mobility of businesses and individuals limit governments' ability to respond by boosting tax rates and revenues.

It is realistic to expect that governments will increasingly focus their investments in charities in the so-called "government-aligned" segment of the sector. This places the more than $25 billion that governments invested in "unaligned" charities in 2016 at some risk. (Governments currently invest more than $151 billion in government-aligned charities.)

It is not realistic to expect that governments will be able to play as active a direct funding role as they have in the past. This leads us to two primary conclusions:

1. Charities and nonprofits will need the flexibility to increase their revenues from non-government sources. The federal government will have a significant role to play in creating an environment in which this diversification can occur.
2. Government investments in charities need to be administered in a more efficient manner, freeing up more resources for front-line work and organizational stability.

The first point will be address in sections below.

With regard to the second point above, in December of 2006 the federal government received a comprehensive report and recommendations from an Independent Blue Ribbon Panel on Grant and Contribution Programs. The Panel identified significant difficulties with the way that departments and agencies administer grants and contributions. Among the issues highlighted by the Panel, and on which recommendations were made, are the following:

- funding approvals need to be more timely;
- organizations should be provided with funding up-front, rather than after a program has ended;
- multi-year funding agreements need to be made so that organizations can plan their operations and human resources more efficiently;
- the full costs of delivering a program on behalf of the federal government – including information technology, management and administration, and occupancy costs – need to be eligible and incorporated into grant and contribution agreements;
- departments' and agencies' administrative policies too often discourage innovation and well-thought out risk;
- terms and conditions need to be flexible enough to allow program changes and adaptations based on early learnings; and,
- evaluation costs need to be recognized as eligible for funding.

The Independent Blue Ribbon Panel made excellent recommendations on these and a number of other issues. Sector organizations, including Imagine Canada, expended significant effort participating in the consultation process and were very pleased with the recommendations.

To date, though, the Blue Ribbon Panel recommendations have been implemented sporadically, if at all. There have been some notable examples of progress: Global Affairs Canada and the Department of Canadian Heritage are often cited by sector organizations as leaders, and the Treasury Board recently issued guidance authorizing and encouraging departments and agencies to allocate a portion of grant and contribution funds for risky and innovative projects. But more than a decade later, we await a comprehensive government-wide response to the Blue Ribbon Panel.

Recommendation 3: That the Special Committee encourage the government to revisit the recommendations of the Independent Blue Ribbon Panel on Grant and Contribution Programs, and ensure government-wide adoption of the Panel's recommendations.

Donations and philanthropy

Philanthropy is undergoing a tectonic shift. In partnership with the Rideau Hall Foundation, Imagine Canada recently published *30 Years of Giving in Canada*, the most comprehensive overview of charitable giving in Canada. While overall donation levels have recovered from the financial crisis of several years ago, charitable giving is increasingly concentrated among a smaller number of primarily older donors. Donors over 70 now account for $2.9 billion in giving; over the next decade, replacing these dollars will be a significant challenge.

In comparison to many other countries, Canada has a very generous tax regime to encourage charitable donations. Individuals can receive a non-refundable tax credit on their charitable donations, and they can carry donations forward for five years in order to make maximum use of that credit. Donations of publicly-listed securities are exempt from capital gains taxes. Corporations derive tax benefits from cash and in-kind charitable contributions.

In 2012, the House of Commons Standing Committee on Finance held hearings and released a report and recommendations on encouraging charitable giving in Canada. A number of proposals were put forward and highlighted by the Committee. Among those, two were acted upon:

- The 2013 federal budget introduced a temporary First-Time Donor's Super Credit. This added 25 basis points to the tax credit for individuals claiming a charitable donation for the first time. This measure was allowed to expire after the five-year period that was legislated.
- The 2015 federal budget announced the extension of favourable capital gains treatment to donations of real estate and private company assets. It is estimated that this would generate $200 million a year in new charitable giving. This measure was not, however, legislated prior to the 2015 federal election and in 2016, the federal government announced it would not proceed with the measure.

In 2016, a private member's bill was introduced in the House of Commons which would have increased the charitable tax credit to match the tax credit available for donations to political parties, but without subjecting donations or the tax credit to the annual limits that apply to political donations. This bill was defeated at second reading in the House.

Research indicates that tax credits are not a primary motivation or barrier when it comes to Canadians' giving habits. Nonetheless, fully one-quarter of Canadians surveyed do cite the tax credit as a motivation for giving.

Alongside the *30 Years of Giving* effort, Imagine Canada has carried out extensive research on charitable giving my different income groups. We find that donors making $50,000 a year or less are among the most generous, donating 2.29% of their income to charity; only those Canadians with $900,000 or more in annual income are more generous.

We estimate that if all Canadians making more than $100,000 a year donated one percent of their income to charity, and if those in that income range already donating more than one percent simply maintained their current donation levels, some $1.6 billion a year in increased donations could be unlocked. However, our research also indicates the difficulty in creating such a societal norm. This is an issue that the sector itself needs to take the lead in tackling.

Recommendation 4: That the Special Committee encourage the federal government to reconsider its decision regarding capital gains taxation on donations of real estate and private company assets.

While maintaining current giving, and finding ways to increase it where possible, is part of the sustainability puzzle, it is not on its own a solution to the long-term challenges posed by the social deficit.

Earned income

As noted above, for "unaligned" charities, earned income represents a significant share of revenues. Given the fiscal constraints that governments are likely to face in the coming years, and the challenges in maintaining and expanding donations by Canadians, increasing this stream of revenue is likely the most realistic way for organizations to achieve financial sustainability.

Depending on whether they are charities, nonprofits, or social enterprises, organizations face different barriers in achieving this goal. Many of these barriers are regulatory or administrative in nature.

- The CRA has guidance regarding when and how charities may engage in business activities. The guidance itself is based on common law principles that have not been significantly updated since the 19th century. Charities are restricted in the types of business activities in which they can engage and in the partnerships they can enter into with other entities.

- Because they can not issue shares or equity, charities have great difficulty accessing capital to invest in revenue-generating activities.
- Charitable foundations are limited in the extent to which they can make Program Related Investments, further restricting the capital potentially available to sector organizations.
- Where government initiatives exist to encourage entrepreneurialism and access to capital, charities and nonprofits are often – through program design or administrative policies – deemed ineligible.
- Nonprofit corporations are theoretically not allowed to run profitable business lines, even if those profits are being generated to support the organizations overall mission and money-losing activities.
- Where charities operate mission-related businesses, it is not clear whether they can claim certain tax benefits. We are aware, for example, of one small charity that loses $30,000 a year because its financial and legal advisors are unable to state with certainty whether it can claim GST input credits related to its business activities.

The rules under which charities and nonprofits operate – be they legal, regulatory, or administrative – reflect an outdated reality and an outdated view of what these organization do and how they operate. This has been increasingly recognized in recent years:

- Mandate letters to the Ministers of Justice, Finance, and National Revenue commit the federal government to a new legislative regime for charities and nonprofits.
- The Consultation Panel on the Political Activities of Charities, reporting to the Minister of National Revenue in 2017, recommended a significant modernization of how charities are regulated overall, not just with respect to their advocacy and public policy activities.
- The Social Innovation and Social Finance Strategy Co-creation Steering Group, the recommendations of which were made public in August, spent a year studying the social purpose sector in depth, and recommended regulatory modernization for charities and nonprofits. The Steering Group also made a number of specific recommendations regarding access to government programs, the need for comprehensive data and research, the need for a home in government, and access to capital.

We note that many comparator countries, with the same common law traditions as Canada, have recently undergone modernizations processes. These include the United Kingdom, Australia, New Zealand, and Ireland. There are different models from which we can learn lessons and which we could adapt to Canadian realities.

We also note that the federal government made significant investments in the Voluntary Sector Initiative in the early 2000s. However, the recommendations for legal and regulatory reform – which were jointly developed by the sector and federal government representatives – have not been implemented. Many of the observations and recommendations emerging from the VSI will be relevant today.

Recommendation 5: That the Special Committee encourage the federal government to launch, in partnership with the social purpose sector, a two-year long co-creation process aimed at modernizing the legal and regulatory regime under which charities and nonprofits operate.

Recommendation 6: That the Special Committee encourage the federal government to work with the sector to prioritize and implement recommendations made by the Social Innovation and Social Finance Strategy Co-creation Steering Group.

Conclusion

Social purpose organizations – charities, nonprofits, and social enterprises – do not exist outside the economy, but are a large and vital part of it. Healthy and strong communities are prosperous and competitive communities, our sector is all about communities.

As a sector, we are grappling with many of the same challenges related to demographics as governments and the private sector. But these challenges manifest themselves in ways that are unique to us, and the solutions must be unique to us as well.

We are a sector of innovators – our business is to test and develop solutions to some of the most intractable challenges that communities face. We are ready to tackle the challenges that we ourselves face, but we cannot do it alone. We are not looking to governments to solve these challenges for us, but we are looking to the federal government to embrace change, to think of our contributions in a different way, and to work with us towards unleashing our full potential.