

# INFO SHEET

## Starting a social enterprise business inside a charity



Operating a social enterprise business inside a charity that does not operate within the strict parameters established by the Canada Revenue Agency (CRA) could result in a revocation of charitable status and/or the payment of taxes and penalties.

Registered charities that are designated as “charitable organizations” or “public foundations” are permitted to carry on “related” businesses. Registered charities that are designated as “private foundations” are not permitted to carry on any business activity, whether related to their charitable purposes or not. The designation a charity receives depends on its structure, source of funding, and mode of operation. The differences between these designations can be summarized as follows:

- The “charitable organization” designation is given to organizations that primarily carry out their own charitable activities. More than 50% of the directors, trustees and officers of a charitable organization deal with each other at arm’s length, and it generally receives the majority of its funding from arm’s length sources.
- The “public foundation” designation is given to charities that typically give more than 50% of their income to other “qualified donees.” More than 50% of the directors, trustees and officers of a public foundation must deal with each other at arm’s length, and it generally receives the majority of its funding from arm’s length sources.
- The “private foundation” designation is given if 50% or more of the charity’s directors, trustees or officers do not deal with each other at arm’s length and/or 50% or more of its funding comes from a person or group that controls the charity.

### What does the CRA consider “carrying on a business”?

The CRA describes a “business” as follows:

*In general terms, a business involves commercial activity—deriving revenues from providing goods or services—undertaken with the intention to earn profit.*

The CRA will consider the specific facts and circumstances of each case to determine if an activity is considered to be a business:

- **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.



## Exceptions

Some activities are intended to generate a profit but are not considered to be businesses:

- **Soliciting donations:** This is not considered to be a commercial activity because donors do not expect any good or service in return for their contributions. Since the activity is not commercial, it is not considered to be a business.
- **Selling donated goods:** This is not considered to be a commercial activity because businesses do not depend on donations to create their inventories. Further, in selling off donated items, the charity does not assume the costs or level of risk usually associated with running a business. Rather, it merely seeks to convert a donated asset into cash.

The CRA also does not typically consider **fees charged for charitable programs** to constitute a “business.” Programs remain charitable as long as they manifest the two essential characteristics of charity—altruism and public benefit. The following are some of the indicators that a charitable program involving a fee is not a business:

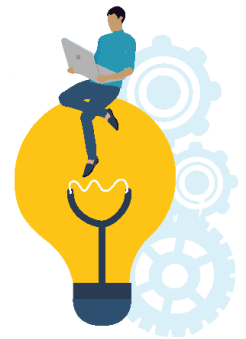
- The fee structure is designed to defray the costs of the program rather than to generate a profit.
  - However, when a government pays a charity to provide a program to the public on the government’s behalf, this revenue also needs to be

considered, in addition to any fees paid by the public, when determining whether the intention of the program is to generate a profit.

- The program does not offer services comparable to those otherwise available in the marketplace.
- The fees are set according to a charitable objective as opposed to a market objective. For example, they are designed to relieve poverty by being set in accordance with the users' means, or to promote broad public participation in an educational program, such as waiving admission charges to an art exhibit.

**Deriving income from investments** can also be different from carrying on a business. Distinguishing between the two is a question of fact. In a sense, both businesses and investments depend on the use of assets. The type of asset is not always a reliable guide—while there are many kinds of assets more typically associated with investments, such as common or preferred shares and bonds, there are other assets, such as real estate and royalty interests, that may equally well be used by investors and businesses. However, income from investments does share a number of characteristics:

- Investment income is derived primarily from the mere ownership of the asset. It is not dependent on active trading such as conducted by dealers who buy an asset in order to sell it as soon as possible at a profit, or the exploitation of the asset such as conducted by manufacturers or resource companies.
- With investment income, the risk to the charity is generally limited to the purchase price of the asset.
- Deriving investment income is also fundamentally a passive activity, in that it does not call upon the charity to take any active role in operating the underlying business.



The CRA has conceded that certain commercial activities can actually be considered charitable in and of themselves when they directly further an organization's charitable purposes; these activities are labelled as **community economic development** ("CED") activities. Generally, CED activities involve improving economic opportunities and social conditions of an identified community. These activities typically fall into the following areas, that are linked to an organization's charitable purposes:

- activities that relieve unemployment;
- grants and loans;
- program-related investments;
- social businesses for individuals with disabilities;
- community land trusts; and
- activities that promote commerce or industry for the public benefit.

More information on [CED activities](#).

## If it is, in fact, a business, is it a “related” business?

The CRA recognizes two kinds of related businesses:

1. Businesses that are run substantially by volunteers (as a rule of thumb, “substantially” means 90%, based on the number of workers as opposed to the amount of time spent); and,
2. Businesses that are linked to a charity’s purpose and subordinate to that purpose.

## How do you know if a business is “linked” to a charity’s purpose?

The CRA recognized four types of linkages that can exist between a charity and a related business:

### 1. A business that is a usual and necessary concomitant of charitable programs



These are business activities that supplement charitable programs. Either they are necessary for the effective operation of the programs, or they improve the quality of the service delivered in these programs.

An example of a usual and necessary concomitant of charitable programs would be charitable theatre organization that operates a food and beverage kiosk located inside the theatre. The kiosk would allow visitors and community members to enjoy refreshments while participating in the events and activities at the theatre. As the kiosk would improve the charitable services of the theatre organization, it would be considered to be a usual and necessary concomitant of the charity.

Other examples provided by the CRA of business activities that are usual and necessary concomitants of charitable programs include:

- A hospital’s parking lots, cafeterias, and gift shops for the use of patients, visitors, and staff.
- Gift shops and food outlets in art galleries or museums for the use of visitors.
- Book stores, student residences, and dining halls at universities for the use of students and faculty.

### 2. A business that is an off-shoot of charitable programs

In the ordinary conduct of its charitable programs, a charity may create an asset that it can exploit in a business. The charity carries out its charitable programs, not in order to create the asset, but to achieve its charitable purpose. The asset is simply a by-product of the charity’s programs.

An example of a business that is an off-shoot of a charitable program is EthniCity Catering, a social enterprise that operates within the Centre for Newcomers (CFN) in Calgary. The mission of CFN, a registered charitable organization, is “to support newcomers and the receiving community in becoming a diverse, united community, through services and initiatives that create conditions of success for newcomers and that foster a welcoming environment in Calgary”.

The objects of CFN have not changed since it was originally incorporated as the Calgary Menonite Centre for Newcomers Society in 1988. These objects are very broad and include: promoting opportunities for friendly social activities; assisting in finding employment and job re-training; and providing or locating employment opportunities.

EthniCity Catering began as a peer support group for women in a church basement in 1997. The program focused on providing female immigrants and refugees with healthy social activities in order to encourage community participation. Cooking together became a central aspect of the program. CFN determined that food generated through this program could be sold to the local community to generate revenue for the charity. Realizing this opportunity, the CFN has developed EthniCity Catering into a full commercial kitchen, providing Canadian culinary work experience and training to immigrants and refugees to facilitate their transition to Canada. The business is related to the charity’s purpose because the program aims to provide support and work experience to immigrants and refugees, with the food for catering service as a “by-product” of the charitable program.

### **3. A business that arises from the use of a charity’s excess capacity**

This type of business activity involves using a charity’s assets and staff, which are currently needed to conduct a charitable program, to gain income during periods when they are not being used to their full capacity within the charitable program.

An example of using excess capacity would be a charity that employs two full-time IT employees, but only requires 1.5 full-time IT employees and could not attract part time staff. The charity could contract out half of an IT employee’s time on an ongoing basis to a for-profit company. The company would pay the charity fair market value for the used of this staff member’s time.

Other examples provided by the CRA of “excess capacity” businesses include:

- A charity’s program is a two-week arts festival held outdoors in July. The charity must have tents to protect the performers and exhibits from the weather. No suitable tents are available in the community for rent, so the charity decides to buy its own tents. During the rest of the year, the charity can rent out the tents as a related business.
- During the academic year, a university needs classrooms and student residences to operate. However, during the summer months, they sit empty. The university

can rent out its facilities to conferences or visitors as a related business.

- A church has a parking lot of a size determined by municipal bylaws or by the needs of its Sunday-morning congregation. It can rent out its parking spaces during the week as a related business.

#### 4. A business that simply involves the sale of items that promote the charity or its objects

This type of business activity is linked to a charity's purpose because it involves sales that are intended to advertise, promote, or symbolize the charity or its objects. A product may serve this promotional purpose by virtue of its design, packaging, or included materials. Usually, the items are bought by those who want to contribute to the work of the charity, and they do not compete directly with products produced and sold by for-profit entities.

The Two Wheel View bike shop is an example of a social enterprise that sells promotional products. Two Wheel View is an Alberta Nonprofit Company and registered Canadian charitable organization with the objects of educating youth on leadership and environmental stewardship through their participation in educational bicycle programs and expeditions.



Two Wheel View runs a social enterprise bike shop that sells donated bikes. They also run charitable practicums and employment programs for youth. In addition to donated goods, the bike shop sells “swag”-branded clothing items and accessories with designs that display the organization's name, logo, quotes, and graphics that promote the charity and its programs. The demand for these products usually comes from people who want to support the mission of the organization and Two Wheel View is not a direct competitor with for-profit businesses that produce and sell similar products.

#### How do you know if a business is “subordinate” to a charity's purpose?

A business must not only be linked to the charity's purpose as per one or more of the found linkages outlined in the preceding section, it must also be subordinate to the charity's purpose.

A business will be considered subordinate to a charity's purpose if it remains subservient to a dominant charitable purpose, as opposed to becoming a non-charitable purpose in its own right. To determine whether a business is subordinate, the CRA will look at the business activities in the context of the charity's operations as a whole, and take the following factors into consideration, among other things:

- Relative to the charity's operations as a whole, does the social enterprise receive a minor portion of the charity's attention and resources?
- To what extent is the social enterprise a stand-alone operation? In terms of its staffing, equipment, and physical location, how much is shared with the rest of

the charity's operations?

- Do the organization's charitable goals continue to dominate its decision-making?
- Has any element of private benefit entered into the charity's operations? How many salaried employees does the social enterprise have?

If a business is not both linked AND subordinate, it will not be considered by the CRA to be a related business.

## If the business is "unrelated" what are my options?

The CRA has stated that if an organization applying for charitable registration is operating an unrelated business, its application will be denied. If your social enterprise idea would be considered "unrelated" to your charitable purposes, there are a few routes you may want to consider:

- If you have not yet applied for charitable registration, consider whether obtaining this status is truly necessary. While becoming a charity has benefits, it is also associated with heightened administrative requirements and operating restrictions. You only need charitable status in the following circumstances:
  - You need the ability to issue Charitable Tax Receipts to donors
  - You need to be able to access funding from charitable foundations and/or government entities that only fund registered charities
  - You need charitable status to bolster your organization's legitimacy/public perception.
- If your organization is already a registered charity, or you determine that obtaining charitable status is truly necessary, you may want to consider revising the business model for your social enterprise or revising your charitable purposes such that it falls within one of the CRA's exceptions to "carrying on a business" or satisfies the criteria of being a related business
- If you do not want to alter the business model of your social enterprise or revise your charitable purposes, consider incorporating a separate entity from the charity.



### Notes

- Much of the foregoing was extracted or adapted from the CRA's Policy Statement on Related Business [CPS-019](#).
- Information current as of December 2020.