Policy Brief - Bill S-216 on reforming Canada's Income Tax Act's Direction and Control requirements

We are recommending that provisions from Bill S-216, The Effective and Accountable Charities Act, be passed into law.

We are asking that you help us ensure that the review and discussion of Bill S-216 be prioritized, such that the bill passes with your support within the first hour of debate on May 16, 2022 with no further delay.

Summary

The private sector is a key driver of long term sustainable and inclusive impact in emerging economies. Through impact investing, international development focused charitable organizations are increasingly partnering with social enterprises to create scalable and lasting impact. Beyond sustainable economic growth, the private sector is also key to reconstruction and resilience in fragile and conflict zones.

Yet despite the potential of impact investing, Canadian charities are currently stifled in their ability to deliver innovative work through partnership with non-qualified donees including social enterprises. Bill S-216 is our opportunity to modernize Canada's Income Tax Act and enable innovative partnerships for impact while ensuring continued assurances on alignment for impact. The bill was mentioned in budget 2022 and enjoys cross partisan support. We are asking for your support to ensure that the bill passes on May 16 after the first hour of debate.

Context

The private sector creates 9 out of 10 new jobs in developing countries and Small and Medium Enterprises (SMEs) represent 66% of full-time employment in developing countries.[1] There is growing research that demonstrates that empowering women economically through private sector initiatives can lead to improved health and well-being outcomes for families and communities.[2] Yet, out of the 8 to 10 million formal women-owned SMEs in developing countries, approximately 70% do not have access to the funding and support they need to

[1]http://www.ifc.org/wps/wcm/connect/5c201d004e2c09d28d32ad7a9dd66321/IFC_Job+Study+Condensed+Report..pdf?MOD=AJPERES
[2]http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---ifp_seed/documents/publication/wcms_329356.pdf

succeed.[3,4] Beyond sustainable economic growth in peaceful countries, **in fragile and conflict zones, "numerous companies are implementing strategies for positive impact** into their core operations" [5] and when it is urgent to reach communities affected by conflict, it is often business networks that enable urgent support to reach the most vulnerable. Rebuilding in Ukraine could be helped by business efforts, especially if and when stewarded and catalyzed by charitable organizations' strategy and impact goals. But for that, charities need to be enabled to work effectively with the private sector.

The global community recognizes the potential impact of charity+social enterprise partnerships. Impact investing is on the rise everywhere in the world, including in Canada.

In Canada, impact investing has grown from $2.1B to $3.5B in assets under management between 2019 and 2021 and 25% of that capital was deployed and managed by Canadian charitable organizations, not-for-profit organizations and Foundations.[6] These changes have also been accelerating elsewhere. For example, since 2000 the European Union has put in place the Social Business Initiative that has spearheaded financial regulations modernization and ecosystem building efforts to accelerate impact investing both for their own sustainable economic growth and as a lever for global development impact.

Regrettably, from a policy perspective Canada is far behind peer jurisdictions. Our impact in the world is held back as a consequence. We at EWB Canada have first hand experience of the unnecessary costs triggered by outdated Direction and Control requirements currently existing in the Income Tax Act.

EWB Canada is an organization bringing together close to 2,000 members from across Canada each year to learn and take action on technology, innovation and global development issues. We have a decade of experience supporting early stage technology startups to deliver access to basic needs in hard to serve communities in Africa. We have supported hundreds of partners in Ghana, Burkina Faso, Uganda, Kenya, Ethiopia, Zambia and Malawi. We have made impact investments to promote climate resilient agriculture practices in Ethiopia, we have supported safe and sanitary low cost housing solutions to slum dwellers in Kenya, we have de-risked FinTechs offering unsecured micro-credit to shop owners in Uganda - to name a few of our successful initiatives. All of that was achieved through partnership with private sector companies

[3] http://www.ilo.org/wcmsp5/groups/public/---ed_emp/---emp_ent/---ifp_seed/documents/publication/wcms_329356.pdf
[4] http://www.goldmansachs.com/our-thinking/public-policy/gmi-folder/gmi-report-pdf.pdf
[5] writes ICRC President Peter Maurer in a new report from the Global Agenda Council on Fragility, Violence & Conflict.

[6] https://www.cafiid.ca/stateofthesector

and all of that under the current Direction and Control regime. Then why change anything, one might ask?

In our experience, direction and control requirements have:

- Imposed a ~20% penalty on our capital investments by creating unnecessary legal costs to backstop and document the minutiae of compliance.
- Limited the types of capital structures we utilize, typically away from modern, nimble and adaptable partnership agreements such as Simple Agreements for Future Equity (SAFE) that are used in most of the startup ecosystem, making Canadian partners like us less suitable and desirable.
- Forced us to limit, prescribe and police the operational decisions made by our partners, instead of supporting them in their own capacity to adapt and decide their own course of action ; which leads to unhealthy and ineffective partnership dynamics.
- Created onerous and misaligned reporting requirements for start up businesses who already have a hard enough time building viable solutions in some of the hardest markets on earth - diverting precious resources of time and attention away from outcomes and impact and toward reporting and control on inputs.

Despite these constraints we have stayed the course - because the potential for exponential impact when working with social enterprises still dwarfs the initial costs of doing the work. Our results prove us right. Millions of people today benefit from improved standards of living thanks to the catalytic innovation work of Engineers Without Borders Canada. Every dollar of charitable donation we have deployed has generated a 20x magnification of impact which is exactly what the United Nations is calling for in order to achieve the Sustainable Development Goals. Replacing Direction and Control by new, outcome based requirements would free us from unnecessary drag at the outset of each partnership and our level of impact could be at least 30% higher at the start of projects, then compounded 20x throughout the life of our work.

The Direction and Control requirements in Canada's Income Tax Act are from the 1950s. It is time to modernize legislation to meet today's reality.

Bill S-216 amends the Income Tax Act to permit charities to provide their resources to a person who is not a qualified donee, provided that they take reasonable steps to ensure those resources are used exclusively for a charitable purpose.

Bill S-222, passed by the Senate of Canada in December 2021 (now reintroduced in this sitting of Parliament as Bill S-216), proposes small yet impactful changes that will modernize Canada's guidance for charitable actors in line with the global standards of other partner countries such as the United States, UK, EU or Australia. The Senate approval of this Bill is also in line with previous Senate and Parliamentary Committee reports, as well as those of charitable sector advisory bodies, calling on such a legislative update.

Bill S-216 would replace the requirement for a charity to exercise “direction and control” over their non-charity partner with a requirement for the charity to take reasonable steps to ensure all of the funds contributed to the project are used exclusively to further a charitable purpose. This provision protects charitable and public dollars while providing a framework to create more equal collaborations or relationships. Charities will be required to demonstrate ‘resource accountability’ and as they do so, will balance the need to demonstrate effective stewardship and accountability for funding to a non-charity with a more modern, respectful approach to creating relationships with non-charities.

The introduction of “resource accountability” in proposed Bill S-216, Canada’s charities will continue to be accountable for using resources towards declared charitable purposes. However, they will no longer have to prove that everything they do (including the work of their partners), is their ‘own activities’, by exercis[ing] full “direction and control” over every activity of their partners.

Other jurisdictions have already made equivalent changes.

The USA, the UK and Europe, to name a few, have already moved ahead with equivalent changes and their impact investing ecosystems are gaining significant momentum as a result both domestically and internationally. In fact, frameworks exist already to ensure accountability on results and impact.[7] See for example the work of the European Union on impact measurement.[8]

The Bill has garnered significant support across Canada

The Special Senate Committee on the Charitable Sector’s report Catalyst for Change: A Roadmap to a Stronger Charitable Sector (recommendation #30) and the first report of the Advisory Committee on the Charitable Sector (recommendation #1) recommended reforming direction and control rules. Additionally, 34 charity lawyers signed a letter in support of direction and control reforms.

It is urgent to act now

Regrettably, as a private bill, the Effective and Accountable Charities Act is not receiving the attention it deserves. It is urgent to pass Bill S-216. We believe that Bill S-216 should and will receive cross-party support because **improving our impact in the world, especially in a time of increasing conflict, is not a political issue. Doing our best to help is a shared Canadian value.** While changes to the ITA Direction and Control requirements were supported “in spirit” in the most recent budget, it is urgent that the bill be passed in parliament.

[7] https://onlinelibrary.wiley.com/doi/10.1002/csr.2235
[8] https://op.europa.eu/en/publication-detail/-/publication/0c0b5d38-4ac8-43d1-a7af-32f7b6fcf1cc

Our request to you is simple: Please help us ensure that your party prioritizes the review and discussion of Bill S-216 such that the bill passes within the first hour of debate on March 13, 2022.

Please write to the Minister of Finance, the Minister of International Development and La Francophonie, and the Minister of National Revenue to ask for their timely review and support for Bill S-216. A template letter will be provided to your Office shortly.

Engineers Without Borders is an international development organization that aims to unlock human potential and accelerate sustainable, inclusive global development through leadership development, advocacy, and small business venture incubation.