PROPOSAL FOR A PROVINCIAL TAX CREDIT TO SUPPORT INVESTMENT IN ONTARIO’S SOCIAL ECONOMY

A BRIEF TO THE PARTNERSHIP PROJECT
FROM THE
ONTARIO SOCIAL ECONOMY ROUNDTABLE (OSER)

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for OSER members

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SUMMARY

A provincial tax credit should be introduced alongside the proposed community bonds to stimulate private investment in nonprofit-led social enterprises across Ontario. Under federal and provincial tax legislation, Canadians are encouraged to make eligible investments. However, none of the existing tax credits are aimed at investments in nonprofit organizations. In provinces where tax credits are in place (Nova Scotia and Manitoba), they have been an effective tool to leverage capital investments for local social enterprises.

BACKGROUND

Ontario’s nonprofits are critical players in the provincial economy and in communities across the province. Ontario’s 46,000 not-for-profit organizations provide jobs to about one in every six employed Ontarians and generate nearly $50 billion in annual revenues. Promoting new investments in Ontario’s nonprofits makes good economic sense.

Ontario’s nonprofits are active and entrepreneurial, but they need a policy framework to expand their funding options to include greater private investments. Ontario voluntary sector organizations are more likely than organizations in other regions of the country to generate their own revenue outside of public funding. However, the recent economic down-turn has had an important impact. Coming out of the recent economic downturn, half of Ontario nonprofits reported financial strain. The vast majority (88%) of charities and nonprofits are now looking for ways to generate new sources of revenue or to boost revenues from current sources. For some nonprofits, this includes activities that generate profits that are then re-invested in the nonprofit corporation, a funding direction supported under Bill 65, the Not-For-Profit Corporations Act.

Tax credits at the provincial and federal level create important incentives for investors. At the federal level, the Investment Tax Credit offers a non-refundable credit or investment in certain types of capital, certain regions of Canada, certain industrial sectors and research and development that are prioritized by the federal government. The federal Income Tax Act also encourages certain forms of investment through deductions for capital gains and securities options, as well as a credit for dividends paid to shareholders by eligible Canadian corporations. Provincially, credits have been offered in the past for labour-sponsored venture funds and community small business investment funds. However, none of these credits are currently available to Ontario nonprofits looking to raise capital outside of traditional grants and donations.

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2. Provincial credits for investments in labour sponsored venture funds were eliminated in Budget 2009. Any provincial support for registered Community Small Business Investment Funds applies only to the
Manitoba’s Community Enterprise Development Tax Credit and Nova Scotia’s Equity Tax Credit offer proven examples of how a new Ontario tax credit could work. Details on each of these provincial measures are discussed in the next section.

### Manitoba’s Community Enterprise Development Tax Credit

Introduced in 2004, the credit offers investors a reduction on their provincial income tax for investments made in an eligible community economic development project. Eligible investments include either registered Community Economic Development Investment Funds (CEDIF) or individual registered community development enterprises. Since the launch of the credit, the province has placed less emphasis on the creation of CEDIFs, but has approved several community economic development enterprises to receive investments under the program.3

Investments in each of the enterprises are eligible for a non-refundable tax credit4 of 30% on the first $30,000 of capital invested by individual Manitobans, to a maximum of $9,000 per investor, per year. The credit can be claimed in the tax year the investment is made, and unused credits can be carried back one tax year or carried forward up to 10 funds grandfathered before 2003 under the Community Small Business Investment Funds Act 1992. See also [http://www.rev.gov.on.ca/en/credit/csbif/](http://www.rev.gov.on.ca/en/credit/csbif/).


4 An non-refundable credit is applied against income tax owing. If non-refundable credits are equal to or greater than the tax owing, no net tax is paid, but no refund will be paid either.

“In effect, if we were to compare the financial tools available to community organizations with those available to for-profit firms, they are limited to seed capital in the form of philanthropic support and grants, with almost no working capital or venture financing.” (Broadhead, 2010, p.100).
years. The combined value of current and carried tax credits cannot exceed $45,000 in a tax year.

Eligible community enterprises must apply and register with the province. These enterprises must be supported by a local community development organization, contribute to local employment (up to a maximum of 200 employees), operate in an eligible business sector and have less than $25 million in gross assets. The form of the investment may include an equity share, partnership interest or a subordinated debt (similar to the community bond proposed by OSER).

Between 2004 and 2008, nine new community enterprises were approved by the province. These social enterprises have raised $1.8 million in new capital from 565 Manitoba investors, or approximately $3,200 per investor. The value of the credit has grown over time to a total of $548,000 between 2005 and 2008. The adjacent figure shows the growth in the capital investments that have been leveraged by the Manitoba credit.

Source: adapted from Chernoff (2008)

To claim the credit, Manitoba tax payers receive a credit slip (T2CEDIC) and complete a declaration (Form T1256) as part of their annual tax return.

**Nova Scotia Equity Tax Credit**

Introduced in 1999, the credit offers eligible investors a non-refundable credit against their provincial income tax when they invest in an eligible community development enterprise directly or through a registered Community Economic Development Investment Fund (CEDIF). CEDIFs have a similar role to holding companies, but are subject to different rules under provincial securities regulations. There are currently 50 CEDIFs in Nova Scotia.⁵

CEDIFs may be structured as a general capital pool or as a purpose-specific fund (for example to raise capital for investment in a particular Nova Scotia community). To be recognized as a CEDIF, an organization must incorporate (federally or provincially) or register as a co-operative⁶. It may not have more than $25 million in assets at the time of registration, must provide the province with a community economic development plan, and meet other criteria on local employment and its management structure. Investments under CEDIFs may be equity investments or under certain circumstances,
loan vehicles. All investments must be sold by an accredited member of the Investment Industry Regulatory Organization of Canada.7

To be eligible beneficiaries of investment, individual Nova Scotia enterprises must meet the same criteria as the CEDIF rules, but must also issue new shares to investors, attract at least three eligible investors, meet local employment thresholds, and be actively engaged in business activities. In addition, they may not use the investment for certain prohibited purposes (such as purchasing assets from the province).

Effective January 1, 2010, the basic Equity Tax Credit was raised from 30% to 35% on the first $50,000 (or $17,500) invested in an eligible community enterprise per investor, per year. Investors must be over 19 years of age, have valid reasons for making the investment, and obtain a receipt from the Nova Scotia Department of Finance. Unused tax credits can be carried forward up to seven years or backwards up to three years. The investment must be held for at least five years, otherwise the value of the credit must be repaid to the province. Information on investors and investments is provided annually to the provincial Department of Finance by the community enterprise or CEDIF.

To promote long-term investments in patient capital, the province offers top-ups to the basic credit. For Nova Scotians who invest through CEDIFs, additional credits are available on the 5th and 10th anniversaries of the original investment. On the 5th anniversary, an investor in a CEDIF earns an additional 20% credit but cannot withdraw the investment for another 5 years. On the 10th anniversary, an investor earns a final 10% credit but again cannot withdraw the investment for a further 5 years. Similar to the basic amount, early withdrawals under the top-up credits are subject to a claw-back of the provincial credits.

Including the top-ups, the Equity Tax Credit has leveraged nearly $40 million in investments in community economic development initiatives in the province. Nearly 5,000 investors have claimed the credit. We estimate the value of each individual investment at approximately $6,600. The chart below shows the value of the credit and the investment it has leveraged in Nova Scotia.

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7 IIROC is the national self-regulating body for investment and mutual fund dealers in Canada.
To claim the credit, investors receive an annual receipt from the provincial Department of Finance and complete a declaration (Form T1285) as part of their annual income tax return.

**Proposal for an Ontario Social Enterprise Investment Tax Credit**

OSER is proposing a non-refundable provincial Social Enterprise Investment Tax Credit worth 30% on the first $50,000 invested in eligible social enterprises in the province by individual Ontarians. This would be equivalent to a maximum credit of $15,000 per investor, per year. The credit would be earned in the year the investment is made, but could be carried forward up to 5 years. To retain the credit, investors would have to maintain their investment for a minimum of 5 years or would be required to repay the credit to the province. A maximum ceiling could be placed on the value of the credit to cap the value of new and carried forward credits in any given year, or to a life-time maximum.

Only nonprofit incorporated nonprofit organizations operating commercial enterprises or engaged in commercial activities would qualify as recipients of the investments. The investment could be made directly into eligible nonprofits or through social finance investment funds such as the Toronto Enterprise Fund. The investment could take the form of a debt such as the community bond proposed by OSER. Invested capital might be used for any commercial purpose or activity of an eligible nonprofit corporation.

Investments could be sold through mainstream financial services providers registered with IIROC.

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8 See [http://www.torontoenterprisefund.ca/](http://www.torontoenterprisefund.ca/) for more information on the fund.
To claim the credit, an individual investor would obtain a receipt from the investment fund or financial services provider and complete a declaration with their annual income tax return.

Investments would not be eligible for other federal or provincial preferential tax treatment, with the exception of deductions for Registered Retirement Savings Plan and exemptions for Tax-Free Savings Accounts.9

Recipient nonprofit corporations or co-operatives should be registered under provincial or federal law and should file, with the province10, a copy of their letters of incorporation or nonprofit co-operative registration as well as a simplified report on the commercial activity or enterprise receiving the investment. The reporting requirement should be balanced to ensure transparency and accountability without introducing onerous reporting burdens. For investments made through a pooled social finance investment fund, the relevant securities regulator framework should be used. Where eligible organizations are issuing community bonds, the proposed offering statement may satisfy the reporting requirement. Final authority to determine eligibility of investments for the tax credit should rest with the government of Ontario.

The take-up rates for the credits in Manitoba and Nova Scotia respectively may provide some estimate of the potential take-up of a new credit in Ontario. In both Manitoba and Nova Scotia, average individual investment levels have been modest amounts of between $3,200 and $6,600. Based on the per capita number of investors in each Manitoba and Nova Scotia, we project that between 1,200 and 12,000 Ontarians may use the proposed credit annually. Using a conservative estimate, if 6,000 investors claim an average of $4,000 in eligible investments, the proposed provincial tax credit could leverage $2.4 million annually in new investments in social enterprises in Ontario.

Interested nonprofit organizations may need technical assistance and advice related to the tax credit, particularly during the initial implementation period. OSER recommends that, similar to the support and assistance provided in relation to the proposed community bonds, nonprofits have access to the technical advice, training and other capacity building they will need to harness the provincial tax credit as part of their funding strategy. Similarly, efforts will be required to inform IIROC members as well as individual Ontarians about the existence of a new credit and how to access it.