

# Community Hub Strategies for Social Enterprise

July 25, 2016

Premier Wynne's Community Hubs Framework Advisory Group released a report titled **Community Hubs in Ontario: A Strategic Framework and Action Plan**

In August 2015, Premier Wynne's Community Hubs Framework Advisory Group released a report titled [Community Hubs in Ontario: A Strategic Framework and Action Plan](#) (the "Community Hubs Action Plan"). The report identified barriers to community hub development and presented recommendations, which the Ontario government is considering as it operationalizes its commitment to fostering community hub development.

For more information on the Community Hubs Action Plan, please see BLG's April 22, 2016 Bulletin: "[Introduction to Ontario's Community Hubs Strategic Framework and Action Plan](#)".

For more information on how recent amendments to rules governing the sale of surplus property by school boards can help hubs find space for social enterprise and other programs, please see BLG's May 11, 2016 Bulletin: "[Disposition of Surplus Properties by School Boards – How New Rules Benefit Community Hubs and Impact Others](#)".

Participating organizations can carry on various activities through the community hub so long as they are aware of the legal risks and obligations involved. In this Bulletin, we will discuss the tax rules associated with carrying on social enterprise activities through the community hub and how careful structuring can alleviate risks and ensure compliance with laws.

## **Social Enterprise Challenges Faced by Registered Charities and Not-for-Profits**

The relationships between organizations participating in a community hub are typically structured and governed by agreements signed by all participants. The type of agreement and appropriate terms will depend on the needs of the parties and the types of activities that will be carried out in the community hub. The Income Tax Act (Canada) imposes additional restrictions if a participant (or the hub itself, if it has a separate legal existence from the participants) is a registered charity or a tax-exempt not-for-profit organization.

Registered charities that are designated as charitable organizations or public foundations are only permitted to carry on "related businesses" (private foundations are prohibited from carrying on any kind of business, whether related or unrelated). Related businesses are commercial activities (a) run substantially by volunteers or (b) linked and subordinate to a charity's charitable purposes. Examples of "linked" and "subordinate" related businesses include museum gift shops, university book stores and hospital parking lots. So, registered charities looking to participate in a hub that includes a social enterprise must be sure the activities and structure complies with applicable tax laws. **Registered charities violating the restrictions under the Income Tax Act (Canada)** may face penalties, suspension of receipting privileges or the ultimate sanction of losing their charitable status (triggering the revocation tax).

**Not-for-profits claiming the income tax exemption under the Income Tax Act (Canada)** are also limited in their activities, but different rules apply. A tax-exempt not-for-profit must be organized and operated exclusively for any purpose except profit. Any profits earned by a tax-exempt not-for-profit must generally be "unanticipated and incidental" and arise from activities directly connected to the organization's not-for-profit purpose or purposes. Significant surpluses are usually "red flags" for the Canada Revenue Agency, although not-for-profits can maintain "reasonable" reserves in most instances. Planned revenue generating activities, where the intention is to earn a profit, are a problem, even if the goal is to invest those profits in other not-for-profit programs. If the conditions **under the Income Tax Act (Canada)** are not met, a not-for-profit that earns a profit can lose its tax-exempt status.

Community hub participants must be aware of these rules when considering and structuring social enterprise activities in a hub or otherwise.

We set out below some structuring alternatives:

#### 1. Social Enterprise Carried On Directly by Hub Participants:

Hub participants can carry on a social enterprise activity directly through increased resources (capital and staff) or through contractual arrangements with third parties, such as joint ventures, leases, licences, or franchises. The advantage to carrying on the social enterprise directly is that hub participants maintain governance control over the activity and utilize available capacity. The disadvantages include risk to a registered charity's charitable status or risk to a not-for-profit organization's tax-exempt status. The situation is increasingly complex if some participants in the activity are registered charities and others are tax-exempt not-for-profit organizations (different analysis would apply), so directly carrying on the activity may not be appropriate for organizations hoping to work together to run a for-profit social enterprise through a "contractual" hub.

#### 2. Social Enterprise Carried On Through a Separate Corporation:

Hub participants may consider carrying on an activity indirectly, through forming a new registered charity, a new tax-exempt not-for-profit corporation or a taxable for-profit subsidiary corporation. There are several advantages of using a separate corporation, including: to limit risk to each participant's charitable or not-for-profit status; to isolate the main assets of the participant(s) from liability from the hub or social enterprise. A key disadvantage of a hub corporate structure is that it requires additional resources and effort to govern (although we have developed tools that can assist in reducing

complexity, cost and risk). From a tax perspective, the ability of a tax-exempt not-for-profit to operate a profit-making activity in a taxable subsidiary is not without limitations. Of course, the separate registered charity or tax-exempt not-for-profit "hubco" must also **comply with the restrictions under the Income Tax Act (Canada)**, but any risk related to a failure to do so is limited to the assets in the "hubco" only. A for-profit corporation is not similarly limited in its activities, but will not enjoy the same tax benefits as a registered charity or not-for-profit corporation, although careful planning with the advice of professional advisors can significantly reduce the impact of applicable taxes through a gift/dividend strategy making this option appealing to many.

### 3. Social Enterprise Carried On Through a Limited Partnership:

A limited partnership hub model is a possible structuring option and one that is ideally situated to provide flexible solutions to complex hub arrangements involving charitable corporations. To implement a limited partnership model, hub participants incorporate a for-profit subsidiary to act as the "active" general partner of a limited partnership (protecting participants from liability), and each becomes "passive" partners, contributing capital in their capacity as limited partners of the partnership but not managing the work of the hub or social enterprise. This approach is advantageous **because revenue flows back to hub participants directly in a more tax-advantageous** manner than a for-profit subsidiary structure. In addition, the hub participants are shielded from liability, as the general partner will be 100% liable for the actions of the partnership. The structure also allows maximum flexibility to bring on additional partners in future, if desired. Like any structure, the primary disadvantages are the cost of governance and compliance. More importantly, hub participants must play a very limited role in decision-making in order to enjoy the legal protection as limited partners. From a tax perspective, there are also limitations for registered charities and tax-exempt not-for-profit holding an interest in a limited partnership.

Ultimately, the structure of community hubs or social enterprise depends on the unique facts of each situation, and creating the correct structure depends on the circumstances. **The starting principle is Keep It Simple! Only introduce structure/complexity to solve challenges facing hub participants.**

Getting advice from professionals who are familiar with these issues is also critical to ensure you get it right and comply with applicable laws.

Borden Ladner Gervais LLP has a diverse group of lawyers across many sectors that can help you deal with these challenges head-on. We have particular experience in working with the "MUSH" (Municipalities, Universities (Colleges), Schools and Hospitals) sector with respect to all types of issues. We look forward to working with our clients to create dynamic community hubs.

By

[Brennan M. Carroll](#), [Nick G. Pasquino](#), [Ryma Sachedina](#)

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[blg.com](http://blg.com)

### BLG Offices

#### Calgary

Centennial Place, East Tower  
520 3rd Avenue S.W.  
Calgary, AB, Canada  
T2P 0R3

T 403.232.9500  
F 403.266.1395

#### Ottawa

World Exchange Plaza  
100 Queen Street  
Ottawa, ON, Canada  
K1P 1J9

T 613.237.5160  
F 613.230.8842

#### Vancouver

1200 Waterfront Centre  
200 Burrard Street  
Vancouver, BC, Canada  
V7X 1T2

T 604.687.5744  
F 604.687.1415

#### Montréal

1000 De La Gauchetière Street West  
Suite 900  
Montréal, QC, Canada  
H3B 5H4

T 514.954.2555  
F 514.879.9015

#### Toronto

Bay Adelaide Centre, East Tower  
22 Adelaide Street West  
Toronto, ON, Canada  
M5H 4E3

T 416.367.6000  
F 416.367.6749

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