



Maintaining Non-Profit Exempt Status: Irreconcilable Differences

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Introduction

“The jurisprudence in this difficult area has led to varying results”

The Gull Bay Development Corporation v. The Queen, (F.C.T.D.)



Paragraph 149(1)(I)

- 149(1) No tax is payable under this Part on the taxable income of a person for a period when that person was...



Paragraph 149(1)(l) (cont'd)

(l) a club, society or association that, in the opinion of the Minister, was not a charity within the meaning assigned by subsection 149.1(1) and that was organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit,



Paragraph 149(1)(I) (cont'd)

- ... no part of the income of which was payable to, or was otherwise available for the personal benefit of, any proprietor, member or shareholder thereof unless the proprietor, member or shareholder was a club, society or association the primary purpose and function of which was the promotion of amateur athletics in Canada.



Club, Society or Association

- Broad definition includes:
 - non-share capital (most) and share capital corporations
 - unincorporated associations
 - trusts
 - partnerships?
 - non-residents



Not a Charity

- Charity:
 - *Pemsels Case*:
 - relief of poverty
 - advancement of education
 - advancement of religion
 - other purposes beneficial to the community
- Registration not required



Purpose Other than Profit

- “organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit”



Purpose Other than Profit (cont'd)

- ‘Social welfare’ means – providing assistance to disadvantaged groups
- ‘Civic Improvement’ includes – enhancement of value or quality of community or civic life
- ‘Pleasure or recreation’ – private clubs
- ‘Any other purpose except profit’ – catch all for orgs operated other than commercial reasons
- Assuming that charitable status is avoided, only a purpose except profit is needed



Purpose Other than Profit (cont'd)

- “organized”:
 - no mention of profit or business in objects
 - *Comptoir de Roberval v. M.N.R.*
 - *Gull Bay Development v. the Queen*
- “operated”
 - Perhaps more difficult to demonstrate whether an entity is operated for a purpose other than profit – case law assists



No Income Payable to a Member

- Applies to proprietors, members and shareholders
- “No...income was...payable to, or...available for...personal benefit”
 - CRA IT496R: “directly or indirectly, to or for the personal benefit of any member”
 - Does section say that?



Why are we discussing this today?

- From mid-2009 to date, CRA has released a number of letters responding to requests for technical interpretations on non-profit organizations
- Such responses indicate a CRA policy shift which is irreconcilable with case law and earlier CRA statements and positions



Tightening CRA Views

- CRA policy shift
 - Started with CRA document number 2009-#0337311E5
- Narrower interpretation
- Profits must be “generally unanticipated and incidental”
- Strict limits on budgeting for surplus



New Technical Interpretations

Document #2009-0337311E5

- the word “exclusively” indicates...none of those purposes may be to earn a profit. Thus where the organization intends...to earn a profit it will not be exempt...even if it expects to use or actually uses the profit to support its not-for-profit objectives”
- Arguably this statement confuses purposes and activities



New Technical Interpretations

- “...earning a profit...does not prevent the organization....from being 149(1)(l) entity. However the profit must be ancillary and incidental to the purposes...” ...



New Technical Interpretations

- “In our view if a 149(1)(l) entity could intentionally earn a profit to finance future capital projects...and we accepted that this did not indicate a profit purpose, than any business where members did not require income distributions could accumulate wealth on a tax free basis...”



New Technical Interpretations

- Re a procurement contract:
“if the organization planned to earn a profit when it entered into the contract - ...if the contract specifically contemplated a “mark-up” the organization would not qualify for the tax exemption”



Tightening CRA Views

- CRA document number 2009-#0348621E5
- Condominium corporation
- Cannot earn an intentional profit
 - Condo rental suite context
- Each activity must be operated on a cost-recovery basis
- IT496R used a residential condominium corporation as an example of an entity that may be operated for a purpose other than profit.



Tightening CRA Views (cont'd)

- CRA Document 2010 – #0358021E5
- Corporate owned cottage property
- Entity provides dining, recreational and sporting facilities to its members
- Corporation to sell vacant land – was capital gain taxable?
- Assuming asset used exclusively in pursuit of non-profit purposes (i.e. dining, recreation, sport) the gain would not be taxable



Tightening CRA Views (cont'd)

- CRA Document 2010 – #0366051E5
- Non-share capital corporation to which cash and other assets would be donated – income earned on assets intended to support non-profit purposes (cultural and other activities)
- CRA says taxable – “maintaining capital property for the purpose of generating income means the organization has a profit purpose”
- Exception may exist where income generating assets themselves are used or spent soon on a non-profit purpose



Tightening CRA Views (cont'd)

- Audit of Private Clubs:
 - CRA has focussed on revenues from non-members
 - Activities such as renting facilities for use by non-members need to be carried on at a cost recovery basis
 - CRA is arguing if such activity is profitable those profits benefit the members (in the form of reduced fees) which is offside requirement income not be payable to or personally benefit the members



Tightening CRA Views (cont'd)

- Bottom line:
 - New, restrictive interpretation
 - Inconsistent with current caselaw
 - *L.I.U.N.A., Gull Bay Development Corp, Canadian Bar Insurance Corporation, BBM Canada*
 - Caselaw suggests the following not fatal:
 - Profits incidental to purposes
 - Not using purposes as a cloak to avoid tax
 - Cash reserves reasonable in relation to needs



BBM Canada v. MNR

- Income derived from its members
- No income distributed to its members
- CRA argued cannot be organized and operated for a purpose other than profit if activities are related to commercial or business activity of members



BBM v. MNR (cont'd)

- Justice Boyle notes S.149 tax exemptions are for entities that are to some extent involved in commerce or business – and refuses to read a public purpose requirement into paragraph 149(1)(I)
- Quotes decisions that confirm organization can have any purpose(s) other than the one disqualifying purpose of profit

Woodward's Pension Society, Otineka, Tourbec



BBM Canada v. MNR (cont'd)

- Mr. Justice Boyle comments that the fact an organization in its planning suggests it needs to operate in a “business-like manner” should not put an organization off-side
- Decision emphasizes that there was no opportunity for shareholders, members or a controlling person to benefit financially



CBA v. MNR

- Court noted high level of commercial activity – but also that profit or loss supported its declared non-profit purpose
- Letters Patent and By-laws supported CBA's position it was organized for a non-profit purpose



CBA v. MNR (cont'd)

- Was the entity operated for a purpose other than profit?
- Court held it was
 - Relied on *Gull Bay* and *L.I.U.N.A. 527 Member's Training Trust Fund*
- Commercial nature of the activity does not equate to a for profit purpose



CRA Audit Initiative

- Warning:
 - Audit initiative
 - Significant reassessments expected of major non-profits
 - Likely new appeals will result
 - Planning, budgeting and reporting issues



The Best Defence is a Good Offence

- CRA policy shift requires careful review of budget and strategic planning processes
- Organizations need to be diligent at costing out programs generating revenues
- Language used in strategic plans and other documents concerned with operations is important



The Best Defence is a Good Offence (cont'd)

- Appropriate reserves are defensible – work with organizations auditors/accountants to establish reserves as appropriate under GAAP
- “Business” language may cause CRA to argue that the organization “intends” to earn a profit



Thank You!



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