CURRENT DEVELOPMENTS IN THE APPLICATION OF PARAGRAPH 149(1)(1) OF THE INCOME TAX ACT

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I. INTRODUCTION

Organizations that meet the requirements of paragraph 149(1)(1) are often referred to as "non-profit organizations" ("NPOs"). This article provides an overview of the law and Canada Revenue Agency's ("CRA") positions on the requirements of paragraph 149(1)(1), with an emphasis on several recent technical interpretations that appear to narrow the circumstances in which CRA will consider an entity to be "organized and operated exclusively for social welfare, civic improvement … or any other purposes except profit."[1]

Paragraph 149(1)(1) of the *Income Tax Act* (Canada) (the "Tax Act")[2] provides as follows:

> 149(1) No tax is payable under this Part on the taxable income of a person for a period when that person was …
> (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, 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;"[3]

There are four key requirements under paragraph 149(1)(1):

(1) The entity claiming the exemption must not, in the opinion of the Minister, be a charity under subsection 149.1(1).

(2) The entity must be a "club, society or association."

(3) The entity must be "organized and operated exclusively for social welfare, civic improvement … or any other purposes except profit."

(4) No part of the income of the entity can be payable or available for the "personal benefit of any proprietor, member or shareholder."

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This article examines each of these requirements in turn.

II. FIRST REQUIREMENT – NOT A CHARITY

The first requirement – that the entity claiming the exemption must not, "in the opinion of the Minister," be a charity – is peculiar. The provision probably should have been drafted to simply preclude entities that qualify for registration as charities from being eligible for NPO status. Such a rule might make sense on the theory that all charities should be subject to the more rigorous regime governing registered charities and the closer supervision of the Charities Directorate.[4] It is difficult to understand what legal or policy purpose is served by "the Minister's opinion" requirement. As might be expected, the courts and CRA have struggled with it.

In L.I.U.N.A., Justice Bowman noted that if the Minister wishes to take a position on the Minister's opinion in court, the Minister must specifically plead the fact of the Minister's opinion.[5] The Minister has the onus of proving it. Bowman J. stated:

> The Minister's opinion, whether that opinion be right or wrong, is, like any other state of mind, a matter of fact. It is a fact that is peculiarly within the Minister's knowledge and it would be unfair to impose on an appellant the onus of establishing a fact relating to the Minister's state of mind when it could easily be established by the Minister.[6]
> …
> If one of the conditions to the application or non-application of a provision of the *Income Tax Act* is the Minister's opinion, the Minister has an obligation to form an opinion and to communicate it to the party affected. He cannot use his failure to form an opinion as a basis for denying the taxpayer's claim. The Minister has failed to fulfill that obligation and accordingly I find that the appellant had no onus to establish the Minister's opinion.[7]

Additionally, Bowman J. explained that, in the absence of an opinion from the Minister, one can presume that the Minister's opinion would be identical to the correct application of the law in the circumstances:

> There is of course an additional reason for not dismissing the appeal by reason of this appellant's failure to adduce evidence of the Minister's opinion. In the absence of any evidence of the Minister's opinion it must be presumed that had he formed an opinion he would have done so on a correct legal basis. If he was properly instructed as to the law he would have concluded that the appellant was not a charity.[8]

CRA in some of its published views has suggested that the requirement in paragraph 149(1)(1) is, simply, that "the organization must not be a charity," without making any reference to the "Minister's opinion."[9]

However, in one recent technical interpretation,[10] CRA was asked for guidance on what

is required in regard to the "Minister's opinion," CRA made the following points:

- Paragraph 149(1)(1) does not actually require the taxpayer to obtain an opinion from the Minister.

- The denial of a charitable registration does not necessarily serve as an opinion of the Minister that the organization is not a charity, since, for example, a non-resident entity would be denied charitable registration even though it is, in the opinion of the Minister, a charity within the meaning assigned by subsection 149.1(1) of the Tax Act.[11]

- Even where an organization does obtain an opinion, the opinion is not valid indefinitely since whether an entity is or is not a charity depends on all of its activities during the year in question.

- In the context of a ruling request, the Rulings Directorate would seek the views of the Charities Directorate as to whether an entity is a charity and the views of the Charities Directorate would be determinative.

- For a taxpayer who does not wish to go through the rulings process to obtain an opinion, CRA could, in the course of an audit, ensure that the taxpayer, who takes advantage of paragraph 149(1)(1) of the ITA, is not a charity.

- A taxpayer who wishes to confirm its admissibility with respect to paragraph 149(1)(1) of the ITA in regard to its activities can contact its tax services office.

All of the foregoing points, although valid, are not particularly helpful. The straightforward answer, perhaps not available to CRA, is that the statutory requirement is simply a legislative *faux pas*.

The simplest way for practitioners to avoid the unnecessary confusion is to include a provision in an organization's objects that precludes the organization, as a matter of law, from being classified as a charity. Following the reasoning in *L.I.U.N.A.*, the Minister's opinion would have to be that the organization is not a charity.

III. SECOND REQUIREMENT – "CLUB, SOCIETY OR ASSOCIATION"

There is no definition in the Tax Act of the terms "club," "society," or "association." Like the "Minister's opinion" requirement, the formulation of this requirement is peculiar.

Not all of the terms used are terms of art at common law or civil law. "Society" is a statutory term of art in some common law jurisdictions,[12] and "association," or at least "unincorporated association," may be developing into a common law term of art, although this is not clear.[13] "Association" is a term of art under the Civil Code of Quebec. The list of selected entities is, from a legal point of view, somewhat random.

The provision probably should have been drafted to refer to "corporations, trusts, associations and unincorporated associations" or, perhaps, "corporations, incorporated societies, trusts, associations and unincorporated associations."

Paragraph 149(1)(1) states that the exemption is available in respect of a "person" when "that person" was "a club, society or association." The statutory formulation, thus, appears to assume that a "club, society or association" is a person. This, too, is peculiar. Like its for-profit analogue, the partnership, the unincorporated association does not have legal personality and, unlike the partnership, there is no equivalent of subsection 96(1) of the Tax Act requiring it to be treated for the purposes of the Tax Act as though it were a taxpayer. "Club" is simply quaint.

To address the obvious difficulty, the definition of "person" in subsection 248(1) provides that "person" includes an "entity" exempt from tax because of paragraph 149(1)(1). Although well-intentioned, this provision merely compounds the confusion, since the reasoning underlying it is plainly circular.

The courts and CRA have struggled with this provision as well.

In *L.I.U.N.A.*, Justice Bowman analyzed whether a trust can be an "association" for the purposes of paragraph 149(1)(1). He concluded that the Local 527 Members' Training Trust Fund, the fund at issue in that decision, was an "association" within the meaning of paragraph 149(1)(1). As part of the analysis, Justice Bowman provided comments on the meaning of "association" for the purpose of paragraph 149(1)(1):

> The fund is a trust for a specific non-charitable purpose formed by agreement between two entities – L.I.U.N.A. and the O.C.A. It is an association consisting of those two entities. The term "association" is a somewhat vague one of some *breadth* and *elasticity*. It implies a relationship between two or more persons for a common purpose.[14]

Justice Bowman then cited two dictionary definitions for association, one English and one French:

> I doubt that I can improve on the definitions in two standard dictionaries:
>
> *Oxford English Dictionary* 2nd Edition:
>
> A body of persons who have combined to execute a common purpose or advance a common cause; the whole organization which they form to effect their purpose; a society: e.g. the British Association for the Advancement of Science, the National Football Association, the Church Association, the Civil Service Supply Association.
>
> *Robert, Dictionnaire Alphabétique et Analogique de la Langue Française:*
>
> Groupement des personnes qui s'unissent en vue d'un but determine.[15]

Bowman J. concluded that it is essential to the existence of an association that there be members or "persons who are associated with one another." His decision holds that certain types of trusts in certain circumstances can qualify as an "association" for the purposes of paragraph 149(1)(1). The particular trust in issue in *L.I.U.N.A.* was a purpose

trust whose legal validity (as a power of appointment and not as a trust) depended on the application section 16 of the Perpetuities Act (Ontario) because it was not otherwise valid at common law as a charitable purpose trust. *L.I.U.N.A.* holds that such a purpose trust can be an "association."

CRA has published several technical interpretations on the question whether a trust can be considered to be an "association" for the purpose of paragraph 149(1)(1). In one, CRA expressed its view that a trust can be considered an association within the meaning of paragraph 149(1)(1) of the Tax Act as follows:

> Subsection 104(2) states that a trust is deemed to be an individual. Subsection 248(1) defines individual as person other than a corporation. If the preamble to 149(1), which refers to a "person for a period when that person was", is read with paragraph 149(1)(1) "a club, society or association", I do not think there is much doubt that a trust qualifies as an organization as referred to in 149(1)(1).[16]

In another, CRA stated its views on this point (and on other related issues) as follows:

> Although it could be argued that a trust qualifies as a non-profit organization ("NPO") pursuant to the conditions set out in paragraphs 5 and 6 of IT-496, that is that a trust could presumably be set up or be organized for social welfare, civic improvement, pleasure, or recreation or for any other purpose except profit, it is our view that by the very nature of a trust, most would have difficulty meeting the NPO requirement of being operated as a NPO on an annual basis. Most trusts would have difficulty meeting the condition that "no part of its income, whether current or accumulated, may be made available for the personal benefit of any proprietor of member". This is so because a trust is generally constituted to hold or manage property for the benefit of one or more beneficiaries. However, having stated that, it is our further view that trusts that are set up, not to benefit specified persons, but to ensure that particular purposes are carried out, i.e., purpose trusts, could qualify as non-profit organizations provided, among other factors, they spend their funds on furthering the non-profit purposes for which they were formed.[17]

Other technical interpretations provide a similar analysis.[18]

It has long been accepted that the term "association" as used in paragraph 149(1)(1) is broad enough to include a corporation. The question arose in *St. Catharines Flying & Training School*[19] in respect of section 4(h) of the *Income War Tax Act*, a predecessor to paragraph 149(1)(1). The taxpayer was a private corporation. There was a provision in its charter prohibiting it from declaring dividends. The Minister argued that the corporation was not a club or society and that the term "association" did not include a corporation incorporated under Part I of *The Companies Act, 1934*, as it then was. The court disagreed, stating:

> The term "association" in its ordinary meaning is wide enough to include an incorporated company.

The court pointed to the inclusion of the words "any stockholder or member" (which have been replaced by "proprietor, member or shareholder" in paragraph 149(1)(1)) as indicating that a corporation was clearly contemplated by the term "association" in the provision.

CRA now accepts that the phrase "club, society or association" is broad enough to include a corporation.[20]

The decision in *L.I.U.N.A.*, in *obiter*, also touched on the question whether an unincorporated association could qualify under paragraph 149(1)(1). One significant challenge in this regard, as mentioned above, is that under the opening phrase in subsection 149(1), only "persons" can qualify for the exemptions in subsection 149(1)(1). Unincorporated associations, of course, are not persons, under the Tax Act, or otherwise. As stated above, the definition of "person" in the Tax Act currently expressly includes reference to any "any entity exempt, because of subsection 149(1), from tax under Part I." This provision does not assist since to be an entity exempt from tax under paragraph 149(1)(1), the entity must first be a person. Nonetheless, although the logic may be circular, CRA appears to take the position that, where an unincorporated association meets the other requirements of paragraph 149(1)(1), it will be considered a person.[21]

CRA has stated that a partnership cannot qualify as a "club, society or association" under paragraph 149(1)(1) because by definition the purpose of a partnership is to earn profit.[22] This position is based on at least one decision.[23] An entity that in all other respects appears to be a partnership but is formed for non-profit purposes can likely qualify under paragraph 149(1)(1) and would simply be well-advised not to refer to itself as a partnership. "Unincorporated association," "association," or "joint venture" would be preferable.

IV. THIRD REQUIREMENT – "ANY PURPOSE EXCEPT PROFIT"

A. Introduction

Under the third requirement, the entity must be organized exclusively for social welfare, civic improvement, pleasure or recreation or for *any other purpose except profit*. In addition, the entity must in fact be operated for such a purpose. This section of the article provides an overview of the law on this question[24] and a discussion of CRA's recent positions.[25]

At the outset, it is worth observing that there is a variety of ways in which the requirement can be conceptualized and formulated. What does it mean, precisely, for a social organization or a legal entity to have a purpose or purposes other than profit?

In our view, the following conceptual points can be made in partial response to this question:

- First, it is apparent that the non-distribution constraint (i.e., the principle that distributions to members during the existence of the entity are prohibited), by itself, is not a sufficient answer, since the requirement to have not-for-profit purposes and

the prohibition against distributing to members (and others) are stated in paragraph 149(1)(1) as two separate rules.

- Second, in any particular case, the evaluation should focus on more than the stated objects of the legal entity under examination; the activities of the organization are also important. The evaluation should be of the "true" purposes, not just the stated purposes of the entity during the period under evaluation.

- Third, if the stated purposes are all not-for-profit purposes and if the activities conform to these stated purposes, the requirement should be considered to be met. The time frame over which the "true" purposes are determined should be a function of the circumstances. The main relevant circumstances will typically be the nature of the not-for-profit purposes and the economic and social reality in which they are pursued. There is no warrant in the Tax Act or in logic, in our view, for restricting the evaluation to the taxation year in question, just because the condition must be satisfied in the year subject to review. Such an arbitrary limitation of the evaluation of the "true" purposes of the entity would be inconsistent with the basic idea of a purpose test.

- Fourth, the requirement should not be read as a prohibition against the profitable pursuit of not-for-profit purposes. If that were the intended meaning of the rule, the statutory requirement would be phrased as a prohibition against profit-making, not as a purpose test. Can a member-owned golf course charge green fees that it knows will result in profits from its golf activities? Can it do so consistently, year after year? In our view, "incidental" profits, meaning profits that are a byproduct or incident of an activity but not the activity's point, anticipated or unanticipated, generated in the pursuit of a not-for-profit purpose should be permissible under a purpose test. Consistently profitable activity is merely evidence of a profit purpose, not proof of it.

- Fifth, it is not clear as a conceptual matter what role the intended or actual use of any profit should play in the evaluation. Can an activity that is ostensibly aimed at profit, be, in reality, aimed at a not-for-profit purpose on the basis that the intended profit is intended to be used and is used to subsidize a not-for-profit purpose? Can an NPO hold a bake sale (or invest savings profitably)? Is the bake sale (or investing) a prohibited profit-purposed activity, or does it take its characterization from the destination of the profit? In our view, "subsidiary" (or subordinate) profit-making activity of this type (i.e., where profits are intentionally earned to subsidize the not-for-profit purposes) should be permissible under a purpose test on the basis that the subsidiary activity takes its characterization from the dominant activity.

- Sixth, can a not-for-profit purpose be pursued in a way that intentionally returns a profit if the profit is used to subsidize another not-for-profit purpose? In other words, can an activity have both a dominant and subsidiary purpose, where the latter takes its character from another dominant purpose? Can an NPO make a consistent profit from one of its not-for-profit pursuits that it uses to subsidize a different not-for-profit purpose? Here the activity would be one with a clear not-for-profit purpose but that also earns profits, unlike the situation in point five where the activity and purpose are clearly for profit. In our view, the question and answer are

the same as question and answer in the fifth point.

- Lastly, not-for-profit entities can be usefully classified into several different types. Classifications of not-for-profit entities have been available in the not-for-profit corporation literature for over thirty years. For present purposes, it is useful to recognize an important distinction, from a tax policy perspective, between public benefit not-for-profit entities and mutual benefit not-for-profit entities. With respect to mutual benefit not-for-profit entities, there is a legitimate tax policy concern that any profits earned in the entity are "distributed" or made available tax free to members where they are used to pay for or subsidize benefits to members. In our view, in general, this concern is properly addressed under the fourth requirement of paragraph 149(1)(l) of the Tax Act.

The problem with some CRA's recent positions, as will be seen in more detail below, is that they tend to read the not-for-profit purpose rule as a prohibition against profit-making. As it would be virtually impossible for NPOs to eradicate all profits, CRA does concede that "unanticipated and incidental" profits, in later views, "incidental or directly connected to NFP" objectives, can be acceptable. As a consequence of this extreme (in our view) position, CRA takes the view that the actual or intended use of profits – what CRA and others refer to as the "destination of the funds" – is never relevant to the analysis. In fact, in CRA's view of the matter, pointing to the intended use of a profit, except in certain specific, restrictive circumstances, would be proof of a violation of the prohibition against profit-making since it would contain an admission that a profit was intended. As a second consequence of this extreme (in our view) position, CRA also tends to take the view that NPOs must be run on a "flat" basis over the year in question. This view follows from the prohibition perspective since the prohibition must operate in some relevant time period. CRA, perhaps naturally for a regulator, takes the view that the relevant time period is the current period, i.e., the one in issue.

These positions may be understandable for a tax authority and may even be justifiable as a matter of policy. The statutory scheme in this area is meagre and old, and therefore, perhaps, at least from the regulator's point of view, deficient. The case law, as will be seen below, however, does not wholly support CRA's views. The judicial decisions in this area do recognize a fundamental distinction between a purpose test and a prohibition test. They do not treat all intentional profit-making as conclusive proof of a for-profit purpose. They do not endorse the view that the intended use of the profits, the destination of the funds, is always irrelevant. They do not restrict the evaluation of profit-making activities to the year in question. The judicial decisions, in other words, are much closer to the view that incidental profit-making and subsidiary profit-making, as described above, are permitted. Although the language – incidental, subsidiary and dominant – is not used by the courts, in our view, the reasoning in the leading decisions is largely consistent with it. In our discussion of the cases, we quote extensively from the decisions so that the law is stated accurately. The language of incidental, subsidiary, and dominant is used as, it is hoped, a clarifying gloss.

Interestingly, CRA clearly accepts analogous reasoning in the case of the related business activities of registered charities. Registered charities must be exclusively charitable. At common law, this purpose requirement does not preclude incidental or subsidiary non-

charitable purposes provided the incidental and subsidiary purposes are incidental and subsidiary to dominant charitable purposes. The Tax Act superimposes similar reasoning in relation to the related business activities of registered charities, and CRA accepts the logic of incidental and subsidiary purposes in its own analysis of these rules.[26]

B. The Case Law[27]

1. Woodward's Pension – Dominant vs. Subsidiary Purpose – Objects

In *Woodward's Pension*, the taxpayer was a corporation whose sole purpose was to raise funds to contribute to a pension trust for the benefit of the employees of Woodward's Store. It achieved this objective by borrowing from Woodward's Store to purchase shares in Woodward's Store and selling those shares to the employees on credit. A profit was earned on the interest rate spread. The corporation had no other purpose or activity.

The Court held that the corporation was not entitled to tax-exempt status on the basis that it did not have exclusively not-for-profit purposes. The ultimate objective of contributing the profits to the pension trust was not sufficient. It appears that the Court concluded that the sole purpose of the corporation, in today's language, was fundraising. The Court reasoned as follows (emphasis added):

> It is true that the appellant is not an ordinary commercial company but a society incorporated under the Societies Act, R.S.B.C. 1936, c. 265, that no part of the appellant's property is payable to or otherwise available for the personal benefit of any proprietor, member or shareholder, and that the appellant was organized for the stated object and purpose of assisting in the provision of funds for pensions to be paid to employees and ex-employees of the stores. **Nevertheless, this last-named purpose could not be achieved without the share sale plan which was designed to make a profit to enable the payments to be made to the pension trustees.** In the taxation year in question the appellant earned in interest alone the sum of $31,525.58, a sum which went a long way towards the payments which were made to the pension trustees. The appellant has entirely failed to establish that it was organized and operated exclusively for a purpose other than profit and the findings of the learned President that it was both organized and operated for a profitable purpose are unassailable. This ground of appeal therefore fails.[28]
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> …
>
> **The income received by the appellant was its own income, not subject to the legal claim of any other person. After receipt it was applied by the appellant in accordance with its stated objects.**[29]
>
> …
>
> **There is no obligation to make any payments which would enable the pension trust to assert a claim that the appellant's income was the income of the pension trust. The income might accumulate indefinitely.** In fact, no payments were made to the pension trust during the period 1945 to 1951 when the appellant was building up a surplus. The society might never be dissolved, the objects might be changed, and the by-laws changed.[30]

Woodward's Pension is cited by CRA as supporting the proposition that the intended

use of any profit earned, the destination of the funds, cannot serve as the basis for characterizing the corporation's purposes. We do not believe that the reasoning in the decision goes quite this far. As the last quoted paragraphs show, there was no obligation on the corporation to actually pay the profits to the pension trust. Because of the lack of any such obligation, the sole purpose of the corporation was to raise funds, to make a profit. Had there been a requirement in the objects of the corporation to fund a pension plan and pay pensions, the conclusion of the court might have been different. As the case was presented, the pension purpose was extrinsic to the nature of the corporation because the pension trust was a separate entity in law. Thus, using our language from above, no dominant not-for-profit purpose existed to inform the characterization of a subsidiary for-profit purpose.

2. *Tourbec* – Dominant vs. Incidental Purpose – Activities

In *Tourbec*, the taxpayer corporation carried on a travel agency business and used the profits from the profitable side of the business to subsidize student travel. The reasoning and conclusions in *Tourbec* are also considered by CRA to stand for the proposition that the intended use of the profits is not relevant to the evaluation. The court's reasoning is set out in the following passages (emphasis added):

> **The facts disclosed by the testimony of the witness for the appellant in my opinion demonstrate clearly that it was carrying on a business concern much the same as any other travel agency. From its operations, it made quite considerable profits, at least during the years under appeal. It made a financial contribution, according to its submissions, to certain customers, that is students and young people who used its services.**
>
> Given the facts, I cannot accept the appellant's submissions to the effect that it was an organization whose sole purpose was among those referred to in section 149 (1)(1) of the Act. **The philanthropic aspect of its operations was only incidental to its primary purpose which was to carry on a travel agency business.** That incidental aspect could not have been achieved unless it had been able to make profits from its primary business.[31]
>
> . . .
>
> As in the Woodward's case, the appellant's philanthropic purpose or object could not have been achieved unless it had carried on its business which was a commercial operation for profit.[32]

The conclusion in *Tourbec*, in our language, was that the dominant purpose of the corporation was the profitable business, and that the not-for-profit activity or purpose was merely incidental to that dominant purpose. The purposes were mixed – profit and not-for-profit – and the profit purpose was clearly dominant and the not-for-profit purpose was clearly incidental. So *Tourbec* also does not rule out a destination-of-funds test where the reverse is true, where the for-profit purpose – the bake sale – is subsidiary to the not-for-profit purpose or where the profit is earned incidentally – the profitable green fees – in pursuit of the not-for-profit purpose and is used in the pursuit of that purpose or in the pursuit of another dominant not-for-profit purpose.

3. *Gull Bay* – Commercial Activities

In *Gull Bay,* the taxpayer corporation was founded to "promote the economic and social welfare of persons of native origin who are members of the Gull Bay Indian Reserve (no. 55) and to provide support for recognized benevolent and charitable enterprises…"[33] As one of its activities, the corporation carried on a profitable logging operation on the reserve. The statutory provisions at the time did not restrict the business activities of charitable organizations to "related businesses," as they do today.

The court held that the organization was entitled to an exemption from income tax on the basis of either the statutory exemption in favour of charitable organizations or the statutory exemption in favour of not-for-profit organizations because the organization was operated exclusively for its tax exempt purposes, even though "it may raise funds for this purpose by its commercial lumbering enterprise." The court reasoned that the social welfare activities of the organization were not a "cloak" to avoid payment of taxation on a commercial enterprise but were the real objectives of the corporation.

It is difficult to discern the overall import of this decision. Arguably, in its simplest terms, the decision permits an NPO to carry on profitable commercial activities provided the profits are used in their not-for-profit activities and provided the not-for-profit purposes and activities are not a "cloak" for the for-profit activities: in our language, provided some dominant purposes are not-for-profit, other dominant purposes can be for a profit if the profits are used to subsidize not-for-profit purposes. At one point in the reasons for decision Justice Walsh states as follows (emphasis added):

> **The real issue in the present case appears to be that the corporation was not set up, as its letters patent indicate, to carry on a commercial activity although it is no doubt true that the motive for forming the corporation may have been that it was desirable to provide employment and training to otherwise unemployed Indians on the reserve by engaging in a commercial activity which would not only provide such employment but raise funds to be used for the very worthy social and charitable activities required on the reserve.** However, it was more efficient to carry on this activity through a corporation than to have the Band Council attempt to do it itself. Elections from time to time change the membership of the Band Council and different factions in the Band have different objectives, and while even the corporation was not immune from this, as appears from what happened during the brief period when Chief Esquega was replaced by another chief and his associates, it was nevertheless more practical to operate as a corporation and negotiate as such with the company for whom the lumber was being cut. **If this lumbering operation had been carried out by the Band Council itself it is unlikely that any attempt would have been made to tax the profits of the enterprise. It is certainly the policy of the Department of Indian Affairs to encourage Indian bands to become self-reliant and to improve living and social conditions on the reserves, and there is no doubt from the evidence in this case that a great deal has been accomplished in improving living conditions on the reserve by the work done by employees of the corporation with funds derived from the lumbering operations, and in providing gainful employment for members of the Band who would otherwise be on welfare.**

> I do not believe that because a corporation was formed for these purposes this should alter the liability for income tax.
>
> **The social and welfare activities of plaintiff are not a cloak to avoid payment of taxation on a commercial enterprise but are the real objectives of the corporation.**[34]

The formulation in these passages is not very restrictive and almost amounts to a very liberal destination of funds test. The decision might even be read as saying that as long as profit-making is not stated as part of the corporation's formal purposes, profit-making is permitted.

However, a closer reading of the entire decision suggests that the employment opportunities offered by the profitable logging activities were themselves pursued as part of the not-for-profit purposes and that the profits earned in the logging activities were therefore not a dominant purpose of those activities. On this reading, the logging activities offered employment opportunities. In our language, the profits earned pursuant a not-for-profit purpose (employment opportunities) were incidental and because they were used in the other social welfare not-for-profit activities, they were also subsidiary to those purposes.

4. Canadian Bar Insurance – Accumulation of Reserves

In *Canadian Bar Insurance*, the taxpayer was incorporated as a non-profit corporation to facilitate the provision of insurance products to members of the Canadian legal community at reasonable and stable rates.[35] The corporation's letters patent provided that the purposes and operation of the corporation were not to include profit. The letters patent also provided that the members of the taxpayer corporation were prohibited from receiving any benefit upon the corporation's dissolution or winding-up.

The Court found that the corporation's goal was to deliver insurance products at a reasonable and stable cost. The Minister of National Revenue sought to deny the corporation tax-exempt status under paragraph 149(1)(1) on the basis that it operated for the purposes of profit, since it had reported a profit for the years in question.

During the relevant period, the corporation had three sources of annual revenue: 1) a retained amount, equal to a 5% administration fee, intended to cover the costs associated with the administration of the corporation's insurance programs for its members; 2) a remitted amount constituting contractual payments by the insurance company to the "stabilization reserves" of the corporation, intended to stabilize the cost of insurance for its members; and 3) investment income earned from the investment of funds in the "stabilization reserves."

The Court found that the corporation was tax-exempt under paragraph 149(1)(1). The Court held that the corporation's retained amount, remitted amount, and investment income were not evidence of a for-profit purpose. The accumulation of the remitted amount in the corporation's stabilization reserves was required due to the impossibility of measuring on a year-to-year basis the cost of insuring a particular risk, as well as the need of the insurance company to err on the side of caution when establishing

premiums. As a result, the Court concluded that the large reserves did not reflect a for-profit purpose, but a service-to-members purpose. The Court stated that there was no doubt the appellant was engaging in a high level of commercial activity, but, citing Gull Bay and L.I.U.N.A., the Court concluded that the provision of insurance products at reasonable and stable rates to the legal community in Canada was not a cloak to avoid payment of tax on a commercial enterprise, but rather its true (read dominant) purpose.

The Court noted that the corporation did not compete with the broader insurance industry since it was acting for a restricted class of consumers. With respect to the reserve funds, the Court also noted that when the reserves grew too large, the corporation would use the excess reserves to obtain enhanced benefits for the members without increasing premiums, which also supported its non-profit purpose.

The Court reasoned as follows (emphasis added):

> I am required to determine whether the Appellant is exempt from tax under paragraph 149(1)(l) of the Act (set out in paragraph 2 above). It is implicit in the opening words of subsection 149(1) that a person described in that subsection may very well have income and taxable income but no tax to pay if certain conditions are met. **If the simple act of earning income from any source disqualified a person from relying on the exemption, then the exemption itself would be redundant and meaningless. The exemption has meaning only if a qualified person has income which can be exempt from tax.** Specifically, a "club, society or association" within the meaning of paragraph 149(1)(l) may have income but that income will be exempt from tax if the club, society or association satisfies the conditions in that paragraph. The only two conditions in paragraph 149(1)(l) which are in dispute are whether the Appellant was organized for any purpose except profit and whether the Appellant was operated for any purpose except profit.[36]
>
> ...
>
> **On the question of whether the Appellant was operated for any purpose except profit, it is necessary to take a broad view of everything which the Appellant did and why it was done.** Mr. Whelly stated clearly that the Appellant was operated to facilitate insurance products being made available to members of the Canadian legal community at reasonable and stable rates. He was more precise in stating that the Appellant's goal was to deliver insurance products at cost if possible. Mr. Whelly described a number of the Appellant's activities and explained how each activity was aimed at cost recovery. His evidence in this area was not challenged on cross-examination although counsel for the Respondent later argued that profit must have been a purpose of the Appellant if it was to achieve its declared goals of stable premiums and cost recovery.
>
> The Appellant's profit and loss results seem to support the Appellant's declared non-profit purpose. Those results are in Exhibit 7 and summarized in paragraph 33 above. It is a fact that over the seven-year period 1986 to 1992, the profits and losses were in balance. **And in the nine-year period 1986 to 1994, profits exceed losses by only $693,519 when the Appellant's annual operating expenses in 1994 exceeded $1,000,000. Those excess profits of $693,519 over**

> **a nine-year period are even less significant when measured against gross premium revenue of about $20,000,000 in 1994**. See Exhibit 1, page 155.
>
> **There is no doubt that the Appellant engages in a high level of commercial activity. It invoices and collects premiums.** It negotiates lower commission rates for vending agents. It enters into complicated retention agreements with insurers. And in the period 1985 to 1992, it would receive an amount or pay an amount each year depending upon the result in the insurer's experience report. The formula for receiving or paying is summarized in Exhibit 5 and explained in paragraph 19 above. That high level of commercial activity, by itself, does not prove that the Appellant operated for profit.[37]
>
> …
>
> In a perfect world, the cost of insurance could be determined each year like the cost of a manufactured product but the world is not perfect, and it is in the nature of insuring a specific risk that the cost of such insurance can be determined only over a period of many years. Therefore, it is not possible to fix an annual premium on a pure cost recovery basis. It seems to me that the Appellant has done the next best thing if its goal is to achieve reasonable and stable premiums because (i) it negotiated a fixed margin of profit with the insurer; and (ii) it required the insurer to remit any excess profit (the "remitted amount") so that the Appellant could accumulate such remitted amounts in a reserve to stabilize premiums and, if the reserve grew too big, the Appellant could obtain enhanced benefits for the insured without increasing premiums.[38]

This case can be read as supporting the idea that even where a high degree of commercial activity exists, a dominant not-for-profit purpose should still inform the characterization of other apparently for-profit subsidiary activities.

5. BBM Canada – Public Benefit

In *BBM Canada*, the Minister advanced the novel argument that an organization must provide a public benefit in order to qualify under paragraph 149(1)(1). The appellant in *BBM Canada* was a non-share capital corporation set up to provide impartial and accurate audience measurement data to its members, who were Canadian television and radio broadcasters, and advertising agencies. CRA argued that BBM Canada could not be considered non-profit if its operations were related to the commercial activities of its members and that the members used the information provided by it in their commercial businesses.

The Court rejected the Minister's argument. The Court found that the members of the corporation did not benefit financially from the membership and stated that, although it is not unusual to see a public benefit in organizations exempt from tax under paragraph 149(1)(1), a public benefit or purpose is not a prerequisite to qualifying for the paragraph 149(1)(1) exemption. In *BBM Canada*, the member fees were set in advance on a cost recovery basis having regard to the annual budget for the upcoming year. Any surpluses were reasonable in amount and were used or held for purposes related to BBM Canada's purposes. BBM Canada conducted custom research for members and non-members through a taxable subsidiary corporation. Otherwise, its revenues were received from its members.

The Court cited *Canadian Bar Insurance* and *Gull Bay* as two cases inconsistent with the Minister's position that the purpose of an organization cannot include a purpose that is not for the public good or that is related to commerce or business.

With respect to the issue of when an organization is considered to operate for profit, the Court stated the following (emphasis added):

> The jurisprudence to date is largely very consistent on when an entity will not satisfy the first requirement. It is clear from such cases as *Woodward's Pension Society*, *Otineka,* and *Tourbec* that an entity cannot qualify for the paragraph 149(1)(l) exemption if it is unable to accomplish the objectives for which it was established unless it realizes profits with which to do that. In *Woodward's Pension Society*, the entity could not help fund pension benefits unless it made a profit on its trading in securities. In *Tourbec*, the entity could not provide travel for students at less than cost unless it made a profit on its sales to others. In *Otineka*, the entity could not fund other native organizations unless it made profits on its real estate development activities. BBM is not in such a position and does not fail this threshold test.
>
> It has long been CRA's view, published in Interpretation Bulletin IT-496 "Non-Profit Organization", that some things, such as the realization of significant profits or the accumulation of unreasonable reserves can be evidence of an unstated profit purpose. Other relevant considerations set out in the Bulletin are whether the entity's activities are operated in a normal commercial manner, whether goods and services are sold to non-members, whether it is operated on a profit basis rather than a cost recovery basis and whether it operates in competition with taxable entities carrying on the same trade or business. **I agree that, in appropriate cases, these may be reasonable and relevant considerations, though they cannot all be requirements, they must be weighed appropriately in the circumstances of each case, and none will be determinative. However, in this case their consideration does not lead me to conclude BBM has an unstated profit purpose.**[39]

The Court rejected the Minister's emphasis on BBM Canada's internal reports and memoranda that stressed the need to create a business environment to conduct its activities in a business-like manner. The Court noted that the language of strategic planning reports and action plans is not unique to business or commerce and is used by government and the non-profit sector. The Court also noted that non-profit entities lack a significant attribute of commercial business: "[t]here is no opportunity for their shareholders, members or controlling persons to benefit financially by way of profits, distributions, unrestricted salaries, capital appreciation of the undertaking or its assets, or in similar fashion."[40]

6. Summary

The following is a list of principles or rules that can be drawn from these decisions, and the other decisions that have preceded them. These formulations are in the language of the decisions, rather than our simpler language of incidental, subsidiary, and dominant. However, in our view, they are all consistent with it. The list is intended to provide a

"neutral" statement on the law, in advance of stating CRA's new positions.

(i) Being engaged in a commercial activity in a business-like manner does not necessarily disqualify an organization from qualifying under paragraph 149(1)(1).[41]

(ii) Non-profit purpose does not mean that no profits can ever result from carrying out the purposes.[42]

(iii) For an organization to be operated for the purpose of earning a profit so as to disqualify it from the exemption under paragraph 149(1)(1) (which is premised upon the assumption that such organizations may earn income), it would be necessary that it do more than merely earn passive income. The earning of such income would need to be both an operating motivation and a focus of the organization's activity.[43]

(iv) The objects provided in the organization's Letters Patent are not determinative of its tax-exempt status. Rather, the actual activities of the organization must be examined. When the organization's non-profit purpose becomes incidental to its profit-making operations, such that the incidental aspect could not be achieved without making profits, tax-exempt status may be lost.[44]

(v) Where business activities are extensive and the organization realizes substantial profits from its business activities, the organization's conduct may establish that it is conducting business for the purpose of making a profit.

(vi) An accumulated reserve fund should not necessarily reflect a profit purpose if it is held in furtherance of the non-profit purpose and is a reasonable amount.[45]

(vii) A non-profit purpose does not require a public benefit purpose.[46]

(viii) Business-type language in an organization's reports and memoranda does not necessarily demonstrate a for-profit purpose.[47]

(ix) Opportunities for shareholders, members, or controlling persons to benefit financially by way of profits, distributions, unrestricted salaries, capital appreciation of the undertaking or its assets, or in similar fashion, is evidence of a commercial, for-profit business.

C. CRA's Technical Views

1. Introduction

In the past few years, CRA has published a number of technical interpretations that demonstrate what we believe to be a narrowing of their view on what is required to demonstrate eligibility for NPO status.[48] In this section of the paper, we review some of these in detail. They are not all consistent, and some are "less narrow" than others. In general, in our view, they all gravitate to the "prohibition-of–profits-in-the-current-period" end of a continuum, the other pole of which is the more nuanced and holistic approach of the case law. Our preference would be an approach that is substantially the

same as the approach that is currently applied to the business activities of charitable organizations and public foundations.[49]

As mentioned in the above-quoted passage from BBM Canada, CRA's historic position regarding the permissibility of accumulating surplus funds in excess of an entity's current needs is set out in *IT-496R*, in which the following is stated:

> 7. It will be a question of fact to be determined with regard to the particular circumstances as to whether an association is carrying on a trade or business and if so, whether it will result in a finding that an association is not operated exclusively for non-profit purposes. Some characteristics that might indicate that an activity is a trade or business are as follows:
>
> (a) it is a trade or business in the ordinary meaning, that is, it is operated in a normal commercial manner;
>
> (b) its goods or services are not restricted to members and their guests;
>
> (c) it is operated on a profit basis rather than a cost recovery basis; or
>
> (d) it is operated in competition with taxable entities carrying on the same trade or business.
>
> Generally, the carrying on of a trade or business directly attributable to, or connected with, pursuing the non-profit goals and activities of an association will not cause it to be considered to be operated for profit purposes.
>
> 8. An association may earn income in excess of its expenditures provided the requirements of the [Tax] Act are met. The excess may result from the activity for which it was organized or from some other activity. However, if a material part of the excess is accumulated each year and the balance of accumulated excess at any time is greater than the association's reasonable needs to carry on its non-profit activities (see ¶ 9), profit will be considered to be one of the purposes for which the association was operated. This will be particularly so where assets representing the accumulated excess are used for purposes unrelated to its objects such as the following:
>
> (1) long-term investments to produce property income;
>
> (2) enlarging or expanding facilities used for normal commercial operations; or
>
> (3) loans to members, shareholders or non-exempt persons.
>
> This may also be the case where the accumulated excess is invested in a term deposit or guaranteed investment certificate that is regularly renewed within a year and from year to year, whether or not the principal is adjusted from time to time.[50]

IT-496R also notes that it is a question of fact whether the amount of accumulated excess income would be considered reasonable in relation to the needs of an association to carry on its non-profit activities and goals, which would be determined with regard to the association's particular circumstances, including such things as future anticipated expenditures and the amount and pattern of receipts from various sources. *IT-496R* also states that there may be certain cases where an association requires a time period in excess of the current and prior year to accumulate the funds needed to acquire a capital property that will be used to achieve its declared exempt activities. In that case, the accumulated funds should be clearly identified in the association's accounting records.

In our view, *IT-496R* is already a narrow interpretation of the law. Many of CRA's recent technical interpretations on these issues express positions which are considerably more narrow. Since the actual formulation of the recent positions is important to an understanding of CRA's change in views, we quote from them extensively in the following discussion. At the risk of some repetition, we canvass the main topics – the logic of purposes and intentional profits, the permissibility of accumulating capital for future capital projects, the permissibility of earning investment income, the permissibility of entering profitable contracts; the permissibility of using an idle resource to generate income, the permissibility of using profits to reduce members' fees, the permissibility of earning investment income, and the status of a destination of profits test.

2. On the Logic of Purposes

In the first of the recent technical interpretations, CRA sets out its views on how a purpose test should be understood and applied (emphasis added):

> Paragraph 149(1)(1) of the Act requires that an organization be organized and operated "exclusively" for "any other purpose except profit" in order to be exempt from tax under that provision. **In our view, the use of the word "exclusively" indicates that while an organization may have many purposes, none of those purposes may be to earn a profit. Thus, where an organization intends, at any time, to earn a profit, it will not be exempt from tax under paragraph 149(1)(1) even if it expects to use or actually uses that profit to support its not-for-profit objectives.**
> …
> While the reference to a "primary purpose" in *Tourbec* suggests that a secondary, profit-making purpose might be acceptable for a 149(1)(1) entity, we are of the view that the decision in *Tourbec* means that, for paragraph 149(1)(1) of the Act to apply, an organization's "sole purpose" (or only purposes) must be something other than earning a profit. **In our opinion, the decisions in *Woodward*'s and *Tourbec* support the position that where an organization would be unable to undertake its not-for-profit activities but for its profitable activities, the organization cannot be a 149(1)(1) entity because it has a profit purpose.**
>
> We acknowledge that **a 149(1)(1) entity may earn a profit as long as that profit is generally unanticipated and incidental to carrying out the entity's exclusively not-for-profit purposes** …[51]

The claim in the first bolded argument is that the corporation cannot ever intend a

profit. This is, in essence, the prohibition view. In our view, as argued above, it is not the law. The statutory language focuses on the purposes of the organization, not the specific intentions inherent in each of its activities. As the case law demonstrates, a profit, even a substantial profit, can be intended, without determining the purposes or nature of the corporation. An intention to earn a profit might constitute some evidence of a profit-making purpose, but it cannot be conclusive evidence, as the first argument suggests.

The second bolded passage is incorrect in its characterization of *Woodward's Pension* and *Tourbec*. These two decisions do not support a prohibition against subsidiary profit-making and incidental profit-making.

In the third bolded passage, CRA gives the narrowest possible formulation of an unintended act: "unanticipated and incidental." In CRA's view, the only good profit (in the current period) is, essentially, an accidental profit. This position is clearly inconsistent with *Canadian Bar Insurance* and *Gull Bay*. In both cases the profits in issue were clearly the direct result of intended activity.

The following CRA statement is to a similar effect (emphasis added):

> … As explained above, and in our previous letter, **intentionally undertaking a profitable activity will generally cause an entity to cease to meet the requirements of paragraph 149(1)(1) of the Act, regardless of how the profits are used after the fact.** Profit-earning activities that may jeopardize the tax-exempt status of a 149(1)(1) entity should be carried out through a separate, taxable entity. Alternately, separate tax returns may be required for time periods during which a condominium corporation is not a tax-exempt entity, as paragraph 149(1)(1) applies for "a period" during which certain conditions are met. In this regard, you may wish to consider the application of subsection 149(10) of the Act.[52]

In later views, CRA is less clear that paragraph 149(1)(1) constitutes a prohibition against intended profits. One 2010 CRA technical provides a summary of CRA's developing thinking (emphasis added):

> With respect to the requirement to be operated for any purpose except profit, we have the following general comments that may be of assistance to you:
>
> * An organization can earn profits, but the profits should be incidental and arise from activities that are undertaken to meet the organization's not-for-profit objectives (these profits are referred to below as "incidental profits").
>
> * **Earning profits to fund not-for-profit objectives is not considered to be itself a not-for-profit objective.**
>
> * An organization should fund capital projects and establish (reasonable) operating reserves from capital contributed by members, from gifts and grants, or from accumulated, incidental profits.

> * **Capital contributions, gifts and grants, and incidental profits should generally be accumulated solely for use in the operations of the organization (including funding capital projects or setting up operating reserves) and should not be used to establish long-term reserves designed primarily to generate investment income.**
>
> * Maintaining reasonable operating reserves or bank accounts required for ordinary operations will generally be considered to be an activity undertaken to meet the not-for-profit objectives of an organization. Consequently, incidental income arising from these reserves or accounts will not affect the status of an organization.
>
> * **Limited fundraising activities involving games of chance (e.g., lotteries, draws), or sales of donated or inexpensive goods (e.g., bake sales or plant sales, chocolate bar sales), generally do not indicate that the organization as a whole is operating for a profit purpose.**
>
> **In determining whether an organization is operated for any purpose except profit, the activities of the organization must be reviewed both independently and in the context of the organization as a whole.**
> …
> An organization will not be exempt from tax pursuant to paragraph 149(1)(l) of the Act if earning profits is a purpose of the organization, even if the profits are destined to support the not-for-profit purposes of the organization or another organization. **This "destination of funds" argument has been rejected by the Canada Revenue Agency and the courts on numerous occasions for both charities and 149(1)(l) organizations.**[53]

A 2011 view is to a similar effect (emphasis added):

> **An organization claiming a paragraph 149(1)(l) exemption can earn a profit, as long as the profit is incidental and arises from activities directly connected to its not-for-profit objectives.** The net income reported by the Corporation resulted from activities undertaken to support its not-for-profit objectives (advertising on behalf of members). However, it appears that
>
> (i) the net income was consistent and material, suggesting a profit purpose; and
>
> (ii) there is no plan or need to spend the net income (and no indication of any need for a large operating reserve), suggesting that the net income is being allowed to accumulate for the purpose of earning investment income or for the purpose of creating a capital amount out of an amount that ACo may be claiming as an expense (or both).[54]

The following 2012 view is to a similar effect:

> As noted above, having profits will not preclude an entity from claiming the tax exemption provided by paragraph 149(1)(l) of the Act, as long as the profits are

> incidental and arise from activities that are undertaken to meet the organization's not-for-profit objectives. This means that where the amounts are not material and the profits result from activities that the entity carries out to meet its not-for profit objectives, the entity will remain tax-exempt. In all cases, the profits must be used to further the not-for-profit objectives of the entity and cannot be available for the personal benefit of members. For example, maintaining reasonable operating reserves or bank accounts required for ordinary operations will generally be considered to be an activity undertaken to meet the not-for-profit objectives of an organization. Consequently, incidental profits arising from these reserves or accounts will not affect the tax-exempt status of an organization.[55]

CRA in these two views appears to have dropped "unanticipated" as a condition, thus permitting profits that are intended, provided certain restrictive conditions are met. It is noteworthy that minor fundraising activities are permissible and it is also noteworthy that the basis for this conclusion is that minor fundraising does not indicate that the organization "as a whole" is operating on a for-profit basis.

From our perspective, however, the position in these three views still exhibits some of the defects of the earlier prohibition positions since, in imposing the constraints on profit-making that they do, they restrict profit-making more severely than is justifiable on the basis of the case law. Further, the concession to minor fundraising is inconsistent with the rejection of the destination of funds test, which is discussed again below. Perhaps CRA's intention here is to permit minor fundraising as a *de minimis* exception to the rejection of the destination of funds test. Our suggestion is that the need for the (welcome) inconsistent exception is an indication of a problem with the formulation of the general approach.

3. On the Permissibility of Accumulating Income for Future Capital Projects

In one of the recent technicals CRA expresses its position as follows (emphasis added):

> … it **is not appropriate to take into account the anticipated cost of future capital projects, because that cost cannot, by its nature, be an expense incurred to earn the current revenue**. Thus, in considering whether an entity has a profit purpose, regard must be had to whether the entity is intentionally generating profit in order to finance future capital projects.[56]

There is no warrant in the case law for the conflation of the evaluative time period into the current period.[57] It is clear from *Canadian Bar Insurance* that it is permissible for an organization to accumulate reserves and surpluses over long periods of time in the pursuit of its non-profit purposes. Accumulation of a surplus is not conclusive evidence on the issue of whether there is a for-profit purpose. It is merely evidence of a for-profit purpose, but it is not, without more, inconsistent with exclusively not-for-profit purposes. If the focus is on the purposes of the organization as a whole, it should be permissible for an organization to anticipate and save for future capital costs that are necessary to the effective pursuit of its purposes.

This position just quoted seems to contrast with other expressed positions on setting aside profits for an earmarked capital project. This includes *IT-496R* and more recent

positions where it is stated (emphasis added):

> A 149(1)(1) organization may maintain a reasonable reserve, but the reserve must be for identifiable operating purposes **or for a specific future capital project.** A large reserve maintained for no other purpose than to earn investment income will likely result in an organization not qualifying for the paragraph 149(1)(1) tax exemption.[58]

In another recent technical interpretation CRA draws an inference between the size of a reserve, and the surplus required to generate it, and an underlying for-profit purpose.[59] If the reserve is too large, the surplus must be too large, and if the surplus is consistently too large, one of the purposes must be profit.

4. On the Permissibility of Entering Profitable Contracts

On this topic, CRA has stated the following (emphasis added):

> Whether an organization that has earned a profit qualifies for the tax exemption provided under paragraph 149(1)(1) of the Act is a question of fact. If the profit was incidental and unanticipated, the organization may still qualify as a 149(1)(1) entity. **However, if the organization planned to earn a profit when it entered into the contract–for example, if the contract specifically contemplated a "mark-up," the organization would not qualify for the tax exemption.**[60]

In the bolded passage CRA narrows the evaluative framework to single contracts within the current period. The passage is an instance of the prohibition mentality and is not supported by the case law.

5. On the Permissibility of Using an Idle Resource to Generate Income

On this topic CRA has stated the following (emphasis added):

> In order to meet the requirement of operating exclusively for any other purpose except profit, a condominium corporation can only offer services for which the fees charged are approximately equal to the amount the condominium corporation expects to incur to provide such services. **A condominium corporation cannot intentionally charge fees in excess of costs; to do so is operating with a profit purpose. Thus, a condominium corporation that intentionally rents out a suite for an amount higher than the expected cost of maintaining and operating that suite does not qualify for the exemption provided by paragraph 149(1)(1) of the Act.** This position applies equally to all activities a condominium corporation might choose to undertake, such as the operation of a parking lot, laundry facilities or a fitness/health centre.[61]

In our view, maximizing the return from temporarily idle resources would typically be characterized as a subsidiary purpose. In any event, the bolded analysis is simply an application of the prohibition rule and the current period rule, for which there is no support in the case law.

However, in our view, CRA's reluctance to recognize the legitimacy of the profits earned in this particular technical is understandable since the NPO in this particular technical, as in many of the recent technicals, was a mutual benefit organization, where the income earned by the organization provided or tended to provide a direct and immediate benefit to its members. It therefore had the "flavour" of income. We return to this observation in the next topic.

In a more recent position, CRA was asked whether the income from a condominium corporation leasing storage lockers would affect the NPO's status. CRA provided the following position (emphasis added):

> **An organization claiming a paragraph 149(1)(1) tax exemption can earn a profit, as long as the profit is incidental and arises from activities directly connected to its not-for-profit objectives.** For example, maintaining reasonable operating reserves or bank accounts required for ordinary operations will generally be considered to be an activity undertaken to meet the not-for-profit objectives of an organization. Consequently, incidental profits arising from these reserves or accounts will not affect the tax-exempt status of an organization. Other examples of profitable activities that might be undertaken through a 149(1)(1) organization include running a canteen at a rink used for amateur hockey or a cafeteria at a not-for-profit youth hostel, or charging admission above direct cost for a children's concert (where the not-for-profit purpose of the organization was to organize and promote youth participation in music).
> ...
> We are of the view that **incidental income** from the rental of common areas may be treated as the income of a residential condominium corporation and generally will not affect the tax-exempt status of that corporation. **Incidental, in this context, means both minor and directly related to activities undertaken to meet the corporation's not-for-profit objectives of managing and maintaining the condominium property and required reserves.**
> ...
> Whether the income earned from the rental of the storage lockers (common areas) will affect the NPO's tax status will depend on whether this is incidental income of the NPO. The rental of on-site storage lockers to unit owners (members) of a residential condominium corporation would generally be viewed as an activity undertaken for the purpose of meeting the not-for-profit objectives of the corporation. **As long as the profits from the rental activity were not material, the rental income would likely be considered to be incidental income of the corporation and the rental activity would not jeopardize the tax-exempt status of the corporation. Whether or not profits from a particular activity are material is a question of fact.**[62]

The more lenient result in this technical is perhaps better understood as an oblique indication of the appropriate line for permissible profits in the case of mutual benefits. However, the definition of what constitutes incidental purposes is far too narrow in our view and is not supported by the case law.

6. On the Permissibility of Using the Profits Thereby Generated to Reduce Fees to Members

On this topic, CRA has expressed the following views (emphasis added):

> With respect to your second question, we agree that when a condominium corporation reduces members' fees as a consequence of intentionally charging rent in excess of expected costs, **this would generally be considered to be making the income of the condominium corporation available for the personal benefit of its members**.[63]

The bolded argument, in our view, has considerable merit. Without offering an extensive analysis, it is worth observing that all mutual benefit type NPOs – those NPOs that are organized and operated for the mutual benefit of members (as opposed to public benefit, charitable and religious organizations) – create benefits for their members that in some situations might rise to the level of "income" under an income tax regime, at least theoretically. The circumstances in which such income should be taxed is a technically challenging question. Subsection 149(5), which, quaintly, facilitates the taxation of the investment income of dining and recreation clubs, is a gesture of recognition of this point, but is hardly systematic in its treatment.

In our view, where a profit is earned by a mutual benefit type NPO, and as a consequence, members receive some benefit, directly or indirectly, the fourth branch of the NPO rules is definitely engaged and could in appropriate cases be applied. Where such benefits are consistently earned and consistently "distributed" in this fashion, that might also constitute some, perhaps very strong, evidence that the NPO was, in fact operating with a profit-making purpose. The categorization of NPOs into NPOs of different types (here, public benefit, mutual benefit, charitable and religious) has been available in the not-for-profit corporate law literature for some time. If the Tax Act formulations cannot be improved due to legislative inertia, CRA and the courts might be well advised to use that literature in its interpretation of paragraph 149(1)(1).

7. On the Permissibility of Accumulating Members' Contributions and Earning an Investment Return for Capital Projects

On this topic, CRA has expressed the following views (emphasis added):

> As a final note, we understand that condominium corporations may levy amounts from members that are put aside for identified capital projects, for example, putting a new roof on a building. As the cost of such capital projects may be considerable, the condominium corporation may choose to collect these amounts over several years in order to raise the necessary funds. CRA accepts that collecting amounts in this manner will not, in and of itself, prevent the condominium corporation from being exempt under 149(1)(1) of the [Tax Act]. Moreover, a condominium corporation can earn reasonable interest income with respect to this fund and continue to qualify for the tax exemption. **However, a condominium corporation cannot intentionally collect amounts in excess of what is reasonable to fund these identified capital projects, nor may it use these funds to aggressively earn investment income.** Either of these two actions could result in a condominium corporation not meeting the criteria of paragraph 149(1)(1).[64]

The position expressed in this technical is in line with the technicals quoted at point 5 and 6 above, and in our view is a fair conclusion in the case of a mutual benefit organization. We question whether the same narrow rule applies to public benefit organizations in the next point.

8. On the Permissibility of Earning Investment Income

On this topic, CRA has stated the following:

> There are instances when a 149(1)(l) entity may have funds on hand in excess of its immediate operating requirements. While retaining excess funds may be evidence that an organization is operating with a profit purpose, generally, this will not in and of itself result in the organization failing to qualify as a 149(1)(l) entity. **For example, in our view, a 149(1)(l) entity may accumulate members' contributions over a period of years in order to finance a planned, future capital project. Also, we acknowledge that the entity may earn reasonable investment income with respect to such accumulated funds, even though such income might otherwise be considered anticipated profit.** However, if the excess funds were collected for the purpose of earning investment income rather than for the purpose of funding a specific capital project, then this would be a profit purpose and the organization would no longer be a 149(1)(l) entity.[65]

And in another, to similar effect, CRA has stated the following (emphasis added):

> In our view, based on the facts you have given us, the proposed corporation will not qualify for the tax exemption provided by paragraph 149(1)(l) of the Act. This is because the corporation intends to use the cash donation (or other assets) to earn investment income in order to support its activities. We understand that all of the income of the corporation will be used to fund the cultural and other activities of the organization. **However, the activity of investing cash (or other assets), is generally considered to be undertaken specifically to earn a profit, which is contrary to the conditions of paragraph 149(1)(l). The only exception to this is where cash or other income-generating assets will themselves be used directly to meet an organization's not-for-profit objectives within a reasonable time-frame – in other words, the expectation is that the capital property will either be spent or used directly, within the foreseeable future, on not-for-profit objectives. It is not enough that income will be used to meet the organization's not-for-profit objectives; maintaining capital property for the purpose of generating income for the organization means that the organization has a profit purpose among its other purposes.** The Canada Revenue Agency ("CRA") takes this position based on the words of paragraph 149(1)(l) and various court cases interpreting that provision.[66]

Having taken such a strong position against profit-making activity and, in particular, subsidiary profit-making acts, CRA is hard pressed in these passages to find a justification for earning an investment return on, in its view, legitimately accumulated funds. In these passages, the concession is revoked immediately if the purpose of the excess contributions was to simply save for some indefinite purpose.

It would appear from this reasoning that, in CRA's view, it is not permissible for an NPO to establish an endowment fund. If that is true, this would be in stark contrast with the rules that apply to registered charities. In our view, there is no warrant for this position in the case law. And if it is prohibited in the case of NPOs, it is difficult to see how the same prohibition should not apply to registered charities. On the basis of our reasoning above, saving and earning investment income would in appropriate circumstances be justifiable as a subsidiary purpose. In the case of registered charities, of course, the disbursement quota prevents undue accumulation. Perhaps a similar rule is required in the case of NPOs.

9. On the invalidity of a "destination of profits test"

On this topic, CRA has stated the following (emphasis added):

> **In limited circumstances, it is possible for a 149(1)(l) entity to earn a profit and still qualify for the tax exemption found in paragraph 149(1)(l) of the Act.** Apart from earning certain investment income as described below, **a 149(1)(l) entity may earn a profit that is incidental to the entity's exclusively not-for-profit purposes. However, earning a profit that is incidental to an entity's not-for-profit purposes is not the same thing as earning a profit in support of the entity's not-for-profit purposes. The "destination of funds" argument has been rejected by Canadian courts with respect to the funding activities of both charities (as defined under common law and in section 149.1 of the Act), and 149(1)(l) entities**.[67]

This passage appears to accept incidental profits, which need not also be unanticipated, but it also appears to reject subsidiary profits. This is not consistent with the limited (and welcome) concessions to earning income from investments or from idle resources quoted above. The only purpose in pointing out this inconsistency is to show that there are unresolved and therefore confusing tensions in the expressed views of CRA.

10. On the Permissibility of Owning All the Shares of a Taxable Corporation

Until recently, it was generally believed that CRA would allow a NPO to transfer a profitable division into a wholly-owned taxable entity in order to preserve its NPO status. Informal statements by CRA on this point led some to worry that CRA was also retreating from this position. In one recent view CRA expressed its views on this issue as follows (emphasis added):

> Where an NPO incorporates a C3 [community contribution company] and holds the shares of a taxable C3 subsidiary, this will not, in itself, cause the organization to lose its exemption under paragraph 149(1)(l) of the Act. Generally an organization claiming the exemption can earn a profit, as long as the profit is incidental and arises from activities directly connected to its not-for-profit objectives. If an organization holds shares to earn income from property, it may be considered to have a profit purpose, even if the income from those shares is used in furtherance of the organization's not-for-profit objectives. **However, the CRA has accepted that where an organization that otherwise qualifies for the exemption under paragraph 149(1)(l) of the Act, engages in an income-generating activity that is carried out in a taxable, wholly-owned**

> **corporation, and this corporation pays dividends out of its after-tax profits to the organization to enable the organization to carry out its not-for-profit activities, the organization may still qualify for the exemption as set out in paragraph 149(1)(l) of the Act. The facts of a situation would need to be examined to determine whether a particular holding of shares of a C3 would affect the status of its NPO parent.**[68]

In another recent view, CRA stated the following (emphasis added):

> The fact that an organization incorporates and holds the shares of a taxable subsidiary will not, in itself, mean that an organization does not meet the requirements of paragraph 149(1)(l) of the Act. Generally, an organization claiming the exemption can earn a profit as long as the profit is incidental and arises from activities directly connected to its not-for-profit objectives. The name of the taxable subsidiary may indicate that it could be connected to the not-for-profit objectives of the Association. However, that can only be determined by a review of the objects of both organizations, which we do not have.
>
> **If an organization holds shares to earn income from property, it may be considered to have a profit purpose, even if the income from those shares is used in furtherance of the organization's not-for-profit objectives. However, the CRA has accepted that where an organization that otherwise qualifies for the exemption under paragraph 149(1)(l) of the Act engages in an income generating activity that is carried out in a taxable, wholly-owned corporation, and this corporation pays dividends out of its after-tax profits to the organization to enable the organization to carry out its not-for-profit activities, the organization may still qualify for the exemption as set out in paragraph 149(1)(l).**
>
> Nevertheless, the fact that a 149(1)(l) entity has funds available to provide loans to taxable subsidiaries generally suggests that the organization has retained earnings larger than is necessary to meet the organization's not-for-profit objectives and is therefore not operating exclusively for a purpose other than profit. Earning interest income on those loans also indicates a profit purpose. Moreover, where an organization receives management fees, rents, interest income, or other types of income from a taxable subsidiary, the receipt of that income may indicate a profit purpose that can only be determined by reviewing the facts. As previously stated, an organization claiming a paragraph 149(1)(l) tax exemption can, with certain restrictions, earn a profit; but those profits earned by the organisation must be wholly expended in accordance with the organization's non-profit purposes. In our view, using income, whether incidental or not, to finance profitable activities in a taxable subsidiary suggests that an organization is likely not using its income to support its non-profit objectives. Accordingly, based on the comments above, in our view, an organization that provides loans to a taxable subsidiary would likely not qualify for the tax exemption available under paragraph 149(1)(l) of the Act.[69]

The degree of prevarication in this view is disconcerting. One would hope that, if CRA

takes a consistently narrow view of the not-for-profit purpose test, it would be generous in allowing otherwise qualifying NPOs a way to deal with their non-qualifying divisions.

11. Conclusion

In summary, our view is that these statements by CRA do not reflect the law. First, it is open to question whether it is permissible as a matter of law to evaluate each area of activity of an NPO in regard to its profitability without also taking into account the integration of that activity, and its related profit, into the purposes of the organization as a whole. CRA's apparent view to the contrary leads to an artificial exercise and a fragmented and distorting evaluation of the entity. The statutory requirement is that the organization have not-for profit purposes.

Second, CRA's timeframe for the evaluation appears excessively short in light of the case law. CRA appears to be saying that the organization must run "flat" in all of its domains of activity over the current period, which it appears to regard as very short-term. There does not appear to be support for this excessively shortened time period in the case law. In our view the selection of the relevant timeframe must be connected in a rational and reasonable way to the not-for-profit purposes of the entity and the context within which it operates. CRA's recent positions pay insufficient heed to these considerations.

Third, despite our criticism of CRA's positions, there may be a real problem or a real deficiency in the legislation in regard to the profit-making activities of mutual benefit NPOs. At what point, or under what circumstances should the profits earned be regarded as income to the members, and simply taxed, as under subsection 149(5) in a deemed trust, or in some other fashion. One suspects that to some extent this challenging question was at the root of the litigation in *BBM Canada*. There is not an easy answer, except to say that the current legislation is wholly inadequate.

V. FOURTH REQUIREMENT – "NO PART OF THE INCOME IS PAYABLE OR AVAILABLE FOR THE PERSONAL BENEFIT OF ANY MEMBER"

The fourth requirement is that no part of the income of the organization may be payable to, or otherwise available for the personal benefit of, any proprietor, member or shareholder.

A. Meaning of Income

Subsection 149(2) provides that capital gains and losses are not relevant for the purpose of determining whether income of a non-profit organization is payable or available to its members under paragraph 149(1)(l). On this basis, CRA has recognized that a non-profit organization may distribute any net capital gains to its members without affecting its tax-exempt status.[71] In *L.I.U.N.A.,* the Court recognized that to the extent a distribution of any remaining surplus of the trust upon termination took the form of capital it would not fall within the restriction on payments of income under paragraph 149(1)(l).[71]

CRA has also stated that returns of capital to members are not payments making the income of the organization payable or otherwise available for the personal benefit of such members.[72]

Further, CRA recognizes that certain payments made directly to members will not fall offside this requirement. In *IT-496R*, CRA states that reasonable salaries, wages, fees, or honorariums for services rendered to the association are acceptable for an organization qualifying under paragraph 149(1)(l). Certain commentators have noted that this allowance arises from the long-held interpretation of "income" in paragraph 149(1)(l) as referring to net income.[73]

The Tax Court of Canada has found that where loans were made to members from excess cash of an organization and, in most cases, the loans were not repaid and were simply written off, income was available for the benefit of the members.[74]

Finally, as noted above, recent CRA positions have stated that where profits are limited to certain "incidental" profits they will not be taken into account in determining whether the fourth branch of the NPO rules would apply:

> Profit that is incidental and connected to the not-for-profit objectives of an organization, and that is used within the organization to support those objectives, generally is not taken into account in determining whether income is available for the personal benefit of a member.[75]

B. Personal Benefit

CRA takes the position that where a payment is not directly for the personal benefit of a member but incidentally benefits a member while primarily benefiting the organization, it will not be caught under the restriction against income being available for the benefit of members. Thus, CRA allows for payments made to employees or members to assist in covering or reimbursing expenses for attending various conventions and meetings as delegates on behalf of the organization, where attendance at such conventions and meetings furthers the objectives of the organization. The same logic applies to campaign expenditures of a political party (other than payments to a candidate that are not reimbursements of reasonable expenses).[76]

In *St Catharines Flying*, the taxpayer was a flying school whose directors had made a declaration that its shares be held in trust for its sponsoring club, the St. Catharines Flying Club, such that the club could benefit from any surplus of the school.[77] Six of the school's members were also members of the club, so CRA argued that this meant that income would "inure to their benefit" as prohibited by the predecessor to paragraph 149(1)(l). Finding for the taxpayer, the court noted that this is not the kind of benefit contemplated by the provision and further that there was no evidence that any of the school's members would *personally* benefit from income that went to a club of which they were also members.

A similar situation was commented on in a CRA document where a non-profit organization's members were other non-profit organizations with similar objectives. There CRA found that funds could be directed to such members as this use of funds would be "an acceptable manner of pursuing [the organization's] objects and would not result in a violation of paragraph 149(1)(l) of the Act."[78]

Recently, CRA appears to have taken the view that the source of funds used to provide a benefit will influence whether the benefit is a personal benefit to shareholders and therefore in contravention of paragraph 149(1)(1). In a 2009 position CRA found that where a condominium corporation reduced its members' fees as a consequence of intentionally earning a surplus in renting out one of its units, this would generally be considered to be making the income of the corporation available for the personal benefit of its members.[79] In a later position, CRA stated that a personal benefit to members could be found to arise in a similar circumstance, emphasizing its concern that income not be available for the benefit of members in situations where income is derived from outside (non-member) sources.[80] On the other hand, CRA has said that a personal benefit would not arise where a service provided to a member was funded by the organization out of member fees or contributions.[81]

C. Dividends

It is clear that the actual payment of dividends by an organization would likely result in a situation in which income was payable to members such that the fourth requirement of paragraph 149(1)(1) would not be met.[82] However, even the ability of an organization to pay dividends to its members can taint the organization's ability to qualify under paragraph 149(1)(1). In *Lakeview Golf Club*, a club organized to provide its members with access to golfing facilities was found not to meet the criteria under the predecessor to paragraph 149(1)(1) in part because the income derived from its operations inured to the benefit of its stockholders and was available for their personal benefit.[83] One of the corporation's by-laws provided that dividends, when earned and declared, shall be paid to the shareholders. Even though the evidence showed that dividends had never been paid, the Exchequer Court found the ability to pay dividends contemplated by the bylaws to be "the clearest possible evidence that the directors and shareholders contemplated the possibility of profits being earned" and that in such a case such profits would be available, when dividends were declared, to the shareholders.[84] Further, the court found that the fact that it was possible that dividends could be paid at any time combined with the fact that the corporation held a surplus was offside of subsection 4(h) of the *Income War Tax Act* The Court noted that the surplus increased the value of the shares which, in combination with the ability to pay dividends, meant that the surplus "inured to the benefit" of the members:

> At the end of the fiscal year in 1949 the company had a total surplus on hand and in cash of $22,538.62. While that amount was not distributed to the shareholders, it was at all times possible for the directors to declare dividends to the shareholders to such extent as they had profits on hand. The value of the shares increased to the extent of such income was earned and, therefore, in my opinion such income inured to the benefit of the shareholders or was available for the personal benefit of the shareholders although not, in fact, paid to them.[85]

The Court even found that where surplus was accumulated to perform tasks that would increase the value of the shares, such as building a fence for the club, this too could be seen as income inuring to the benefit of the shareholders.

CRA also takes the position that the power to pay dividends to members negates an organization's ability to qualify under paragraph 149(1)(1). In *IT-496R,* CRA states:

> an association would not qualify as tax-exempt if … it has the power at any time to declare and pay dividends out of income.[86]

In another position, CRA states:

> …where constating documents specifically authorize a distribution of income to an entity's members, it is our view that the entity cannot qualify as [a non-profit organization].[87]

D. Distributions on Winding Up

In *Moose Jaw Flying*, the Exchequer Court of Canada appeared to accept the position argued by the Minister that the ability to distribute the surplus of an organization at some point in the future to its members was enough to prevent the organization from qualifying under paragraph 149(1)(1).[88] Not long after, the Tax Appeal Board in *Moose Jaw Industrialization* denied that this position was taken in *Moose Jaw Flying* and found that the ability of a corporation to distribute its income to members upon winding-up (which could result in a deemed dividend being paid at that time under the Tax Act) was a mere "possibility" or "eventuality" that was not sufficient to show that income inured to the benefit of its shareholders under subsection 4(h) of the *Income War Tax Act*.[89]

More recently, the Court in *L.I.U.N.A.* clarified that the eventual possibility of an organization winding up and distributing its income to its members does not affect the status of the corporation for all years; it only affects the organization's status for the year in which that distribution occurs:

> Where the trust document does not specifically permit the trustees to pay income to the members it is not until a determination is made on winding up to pay a portion of the income to the members that any part thereof becomes payable to or available for the personal benefit of a member. *It is in the year in which that is done that the exemption is lost.*[90]

CRA's position on distributions to shareholders on winding-up has also varied. In its 1978 interpretation bulletin on the winding up of a non-profit organization (now archived), CRA's position appeared to be consistent with the rule stated by Justice Bowman in *L.I.U.N.A.* In fact, Justice Bowman even cited the following paragraphs from the bulletin as a correct statement of the law:

> An organization which has qualified within paragraph 149(1)(1) loses its exempt status at the time it ceases to satisfy the provisions of that paragraph. Subsection 149(6) provides that the exempt portion of the taxable income of an organization which loses its exempt status during a taxation year shall be computed in proportion to the number of days in the taxation year that the organization qualified within paragraph 149(1)(1).

> Paragraph 149(1)(1) provides in part that no part of the income of a non-profit organization shall be payable to or 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. The Department views a corporation as having lost its status as a non-profit organization at the time when a determination is made that, upon winding-up, an amount of income shall become payable to or otherwise available for the benefit of a proprietor, member or shareholder other than those that are excepted.[91]

However, the predecessor to *IT-496R* appeared to take a different stance, stating that an organization would fail to comply with paragraph 149(1)(1) where in the case of a winding-up, dissolution or amalgamation it had the power to distribute income to a proprietor, member or shareholder.[92] A July 2001 document echoed this statement saying the fourth requirement "would likely not be met" if a corporation was not prohibited from distributing income to its shareholders or members on its winding-up, dissolution or amalgamation.[93] However, in the next month CRA revised its interpretation bulletin in *IT-496R* to limit this position in accordance with the reasoning in *L.I.U.N.A.* to the year in which the distribution occurred (emphasis added):

> An association that has been tax-exempt may fail to comply with this requirement on a winding-up, dissolution, or amalgamation. For example, on winding-up, such an association will lose its tax-exempt status *at the time* when a determination is made that an amount of income will become payable to, or otherwise available for the benefit of, a member …[94]

VI. CONCLUSION

Both registered charities and not-for-profit organizations are entitled to an exemption from tax on their income. The legislative and administrative resources devoted to defining, restricting and supervising this tax exemption in the case of not-for-profit organizations are clearly inadequate. The legislative language is obviously flawed and the administrative resources (at least up to now) are meagre. There is a startling contrast in this regard with registered charities. As a consequence, the law is reposited in a handful of judicial decisions and explicated in periodic technical positions published by CRA.

This article has not attempted to identify let alone critique the policy reasons that support the tax exemption in favour of not-for-profit organizations. These are best left for another day. Perhaps the key to understanding the true intention underlying paragraph 149(1)(1), and therefore interpreting it correctly, lies in uncovering its policy rationale. Presumably, the policy rationale has something to do with the fact that, unlike a share capital corporation, the not-for profit corporation cannot be used as a vehicle by its owners for deferring tax. But there is obviously more to it than that. One key question that should be addressed in such an enquiry is the extent to which a not-for-profit organization should be permitted to earn a profit. Beyond the restrictions that arise out of the prohibition against having profit-making as a purpose, what more is required in terms of rules governing profit-making?

One way to interpret CRA's recent technical responses to this question is to regard the narrowing of permissible activities as a fisc-friendly reaction to the inadequacy of the regulatory framework. Although perhaps understandable, it is our view that the new positions do not accord fully with the existing judicial decisions, both in terms of their overall approach to the evaluation and in terms of their specific conclusions on specific issues.

Notes

1. Other comprehensive treatments of the requirements of paragraph 149(1)(l) include: Arthur B. Drache, Robert B. Hayhoe, and David Stevens, *Charities Taxation, Policy and Practice*, (Toronto: Carswell, 2008) at ch 16; R. B. Hayhoe, "2010 Charities Update" in *2010 Ontario Tax Conference* (Toronto: Canadian Tax Foundation, 2010); K. Chan, "Key Differences Between Non-Profit Organizations and Charities Under the Federal *Income Tax Act* " in *2007 National Symposium on Charity Law*, Canadian Bar Association (Toronto: Canadian Bar Association, 2007); T. S. Carter & T. L. M. Man, "Share Capital Social Clubs as NPOs: Issues to Consider" in *Apples, Oranges or Lemons? Legal Issues Arising in the Form, Function and Fundraising of Charitable and Non-for-Profit Organizations*, Ontario Bar Association (Toronto, Ontario Bar Association, 2004); R. B. Hayhoe, "An Updated Introduction to the Taxation of Nonprofit Organizations" (2004) 18 *The Philanthropist 91*; Arthur B. C. Drache, "Charities, Non-Profits, and Business Activities," in *Report of Proceedings of Forty-Ninth Tax Conference*, 1997 Tax Conference (Toronto: Canadian Tax Foundation, 1998); and, R. C. Knechtel, "Tax Treatment of Non-Profit Organizations" in *Report of Proceedings of the Forty-First Tax Conference*, 1990 Tax Conference (Toronto: Canadian Tax Foundation, 1991). CRA sets out its views comprehensively in *IT-496R* – Non-Profit Organization (August 2, 2001) ("*IT-496R*").

2. RSC 1985, c 1 (5th Supp.), as amended. Unless otherwise noted, all statutory references herein are to the Tax Act.

3. The French language version of the provision reads as follows:

> l) un cercle ou une association qui, de l'avis du ministre, n'était pas un organisme de bienfaisance au sens du paragraphe 149.1(1) et qui est constitué et administré uniquement pour s'assurer du bien-être social, des améliorations locales, s'occuper des loisirs ou fournir des divertissements, ou exercer toute autre activité non lucrative, et dont aucun revenu n'était payable à un propriétaire, un membre ou un actionnaire, ou ne pouvait par ailleurs servir au profit personnel de ceux-ci, sauf si le propriétaire, le membre ou l'actionnaire était un cercle ou une association dont le but premier et la fonction étaient de promouvoir le sport amateur au Canada;

As noted by Justice Boyle in *BBM Canada v Minister of National Revenue*, 2008 TCC 341 at para 7 [*BBM Canada*], the English-language wording of this provision has been essentially the same since the *Income War Tax Act* of 1917.

4. CRA does not even have a list of all NPOs since there is no registration requirement applicable to NPOs and all NPOs are not otherwise required to file information returns. Information returns are required under subsection 149(12) of the Tax Act.

5. *L.I.U.N.A. Local 527 Members' Training Trust Fund v R*, 92 DTC 2365 (TCC) [*L.I.U.N.A.*]. For a case comment see D Lisa Goldstein "Current Cases – Non-Profit Organizations can be Profitable" (1993) 41:4 Can Tax J 710.

6. *L.I.U.N.A., supra* note 6 at para 73.

7. *Ibid* at para 75.

8. *Ibid* at para 76.

9. See CRA Doc. No. 2010-0366051E5 – Application of 149(1)(1) of the Act, (May 11, 2010). See also CRA Doc. No. 2010-035583117 – Audit of Non-Profit Organizations (March 10, 2010) and CRA Doc. No. 2010-0358021ES – 149(1)(1) – Entity Sale of Land (June 28, 2010). See also *IT-496R., supra* note 1, which deals with the issue as follows: "If, during a period in a particular year, the Minister of National Revenue considers an association to be a "charity" (i.e., a charitable organization or charitable foundation) as defined in subsection 149.1(1), then it cannot qualify in that period as a tax-exempt NPO. For these purposes, an association may be considered to be a charity even if it is not a registered charity or if its designation as a registered charity has been revoked under section 168."

10. CRA Doc. No. 2009-0329991C6 – Avis du ministre – organisation à but non lucratif = Non-Profit Organizations Status, (October 9, 2009).

11. This is reiterated in CRA Doc. No. 2010-0366051E5, *supra* note 10.

12. See *Society Act*, RSBC 1996, c 433, s 1 "society"; and *Societies Act*, RSA 2000 c S-14, s 1(b) "society." In both cases, a society is an entity incorporated under the statute.

13. See Uniform Law Conference of Canada, "Uniform Unincorporated Nonprofit Associations Act".

14. *L.I.U.N.A. supra* note 6 at para 57 [emphasis added].

15. *Ibid* at paras 57-59.

16. CRA Doc. No. 1990-404 – Whether an entity qualifies as a non-profit organization or as a municipal or provincial corporation (August, 1990).

17. CRA Doc. No. 9413795 – Non profit organization – Purpose trusts (July 25, 1994).

18. See for example, CRA Doc. No. 9419975 – Purpose trust (December 22, 1994), and CRA Doc. No. 9727005 – Non-profit organizations (June 30, 1998).

19. *Minister of National Revenue v St Catharines Flying & Training School*, [1953] Ex CR 259 [*St Catharines Flying*]; reversed on other grounds: [1955] SCR 738.

20. *IT-496R, supra* note 2.

21. CRA Doc. No. 2010-0369701I7 - Unincorporated associations and paragraph 149(1)(l), (July 30, 2010).

22. *Ibid*.

23. *Minister of National Revenue v Begin,* [1962] Ex CR 159.

24. The leading decisions on the question of whether it is permissible under paragraph 149(1)(1) for an association or other entity to earn a profit are the following: *Gulf Log Salvage Co-operative Assn v Minister of National* Revenue (1960), 24 Tax ABC 139 [*Gulf*]; *Woodward's Pension Society v Minister of National Revenue*, [1962] SCR 224 [*Woodward's Pension*]; *Church of Christ Development Company Limited v Minister of National Revenue*, 82 DTC 1461 (Tax Review Board); *Gull Bay Development Corporation v R,* [1984] CTC 159 (FC TD) [*Gull Bay*]; *Tourbec (1979) Inc v Ministre du Revenue national*, 88 DTC 1438 (TCC) [*Tourbec*]; *L.I.U.N.A., supra* note 6; *Canadian Bar Insurance Assn v R,* 99 DTC 653 (TCC) [*Canadian Bar Insurance*]; *BBM Canada supra* note 4; and *Otineka Development Corp v Canada,* [1994] 1 CTC 2424 (TCC) [*Otineka*]. For a case comment on *BBM Canada,* see, A. Stacey, "Current Cases – No Public Purpose Test for Non-Profit Organizations Under the *Income Tax Act* " (2008) 56:4 Can Tax J 923. For case comments on *Canadian Bar Insurance*, see J Unger, "Tax Exempt Status for Non-Profit Organizations: The Case of Canadian Bar Insurance Association" (2001) 4 Charitable Thoughts 5, Lorne A. Green, "Current Cases – Taxation of Not-For-Profit Organizations: The Final Word?" (1999) 47:1 Can Tax J 110.

25. The recent CRA technical interpretations setting out its new position include: CRA Doc. No. 2009-0337311E5-149(1)(1) – organizations (November 5, 2009); CRA Doc. No. 2009-0348621E5 -"Condominium corporations and 149(1)(1)" (December 15, 2009); *CRA Doc. No. 2010-0366051, supra* note 10; CRA Doc. No. 2010-0357831E5 – Condominium corporations and 149 (l)(l) (June 25, 2010); CRA Doc. No. 2010-0380581I7 – Paragraph 149(1)(1) of the *Income Tax Act* (April 7, 2011). For a comment on CRA Doc. Nos. 2010-0366051E5 and 2010-0357831E5, see "Hold the Cookies – The CRA Outlaws Bake Sales for Not-For-Profits," Tax Topics (CCH) (August 2010). See also CRA Doc. No. 2011-0394251I7 – Paragraph 149(1)(1) (April 7, 2011); CRA Doc. No. 2010-0380451E5 – Condominium corporation – solar panels (May 5, 2011); CRA Doc. No. 2011-0398661I7 – 149(1)(1) – profit purpose and income to members (June 10, 2011); CRA Doc. No. 2011-0405541I7 – Condo corporations, cell towers (July 13, 2011); CRA Doc. No. 2011-0410861I7 – Hall charities association and 149(1)(1) (October 21, 2011); CRA Doc. No. 2011-0404731I7 – Paragraph 149(1)(1) (October 24, 2011); CRA Doc. No. 2010-0389021E5 – Application of paragraph 149(1)(1) (January 10, 2012); CRA Doc. No. 2011-0392841E5 – Status of 149(1)(1) entity (February 14, 2012); CRA Doc. No. 2011-0404681I7 – Non-profit organization – sports organization (March 30, 2012); CRA Doc. No. 2011-0408851I7 – XXXXXXXX and 149(1)(1) (March 30, 2012); CRA Doc. No. 2011-0418691E5 – Lease or Sale of Lockers to Members (May 23, 2012); CRA Doc. No. 2011-042623117 – NPO Project, Section 149(1)(1) (June 20, 2012); CRA Doc. No. 2011-0412961E5 – NPO and Taxable Subsidiary, Section 149(1)(1) (September 27, 2012); CRA Doc. No. 2011-042761117 – NPO Project (September 28, 2012); CRA Doc. No. 2012-0448531E5 – Update on NPO audit project (October 16, 2012).

26. See for example Policy Statements CPS -019 - "What is related Business?" (March 31, 2003).

27. Cases in this section are cited at note 25.

28. *Woodward's Pension, supra* note 25 at para 9 [emphasis added].

29. *Ibid* at para 10 [emphasis added].

30. *Ibid* at para 11 [emphasis added].

31. *Tourbec, supra* note 25 at paras 15-16.

32. *Ibid* at para 19.

33. *Gull Bay, supra* note 25 at para 1.

34. *Ibid* at paras 26-28 [emphasis added].

35. *Canadian Bar Insurance, supra* note 25.

36. *Ibid* at para 34 [emphasis added].

37. *Ibid* at paras 39-41 [emphasis added].

38. *Ibid* at para 45 [emphasis added].

39. *BBM Canada, supra* note 25 at paras 45-46 [emphasis added].

40. *Ibid* at para 53.

41. *Gull Bay*, *supra* note 25; *Canadian Bar Insurance, supra* note 25; and *BBM Canada, supra* note 25.

42. *Canadian Bar Insurance, supra* note 25.

43. *Canadian Bar Insurance, supra* note 25.

44. *Gull Bay*, *supra* note 25.

45. *Canadian Bar Insurance, supra* note 25.

46. *BBM Canada, supra* note 25.

47. *BBM Canada, supra* note 25.

48. See CRA technical interpretations, *supra*, note 26.

49. See *Policy Statement CPS-019, supra* note 28.

50. *IT-496R, supra* note 2 at paras 7-8.

51. *CRA Doc. No. 2009-0337311E5*, *supra* note 26 [footnotes omitted] [emphasis added].

52. *CRA Doc. No. 2010-0357831E5, supra* note 26 [emphasis added].

53. *CRA Doc. No. 2010-0389021E5*, *supra* note 26 [emphasis added].

54. CRA Doc. No. 2011-040473117 – paragraph 149(1)(1) (October 24, 2011) [emphasis added].

55. CRA Doc. No. 2012-04555O 1T7 – Non-profit project – (November 21, 2012). See also CRA Doc. No. 2012-0453841ES – Excess membership fees refunded in year to member of non-profit – (October 25, 2012) and CRA Doc. No. 2012-0441801ES – funds payable to members – (February 5, 2013)

56. *CRA Doc. No. 2009-0337311E5-149(1)(1), supra* note 26 [emphasis added].

57. Since this time, CRA has issued one position in which it took a slightly more flexible view. See *CRA Doc. No. 2011-0392841E5, supra* note 26, where it is stated:

    > If an organization is operating at close to cost over the course of a reasonable timeframe (which does not have to be a taxation year), and there is no evidence that material profits from one activity are being used either to cover expenses related to a different activity or to accumulate a reserve, then it is likely that the organization is operating exclusively for a purpose other than profit.

58. *CRA Doc. No. 2011-0410861I7, supra* note 26 [emphasis added].

59. CRA Doc. No. 2012 – O439951I7 – non-profit organization project – (Nov. 20, 2012)

60. *CRA Doc. No. 2009-0337311E5*, *supra* note 26 [emphasis added].

61. *CRA Doc. No. 2009-0348621E5, supra* note 26 [emphasis added].

62. *CRA Doc. No. 2011-0418691E5, supra* note 26 [emphasis added].

63. *CRA Doc. No. 2009-0348621E5, supra* note 26 [emphasis added].

64. *Ibid* [emphasis added].

65. *CRA Doc. No. 2009-0337311E5*, *supra* note 26 [emphasis added].

66. *CRA Doc. No. 2010-0366051E5, supra* note 10 [emphasis added].

67. *CRA Doc. No. 2010-0357831E5, supra* note 26 [emphasis added].

68. *CRA Doc. No. 2012-0456071E5* – non-profit organization and community contribution companies – (January 18, 2013) [emphasis added].

69. *CRA Doc. No. 2012-043995117* – non-profit organization project – (November 20, 2012) [emphasis added].

70. See *IT-496R supra,* note 2 at para 11 and CRA Doc. No. 2010-0358021E5 - 149(1)(1) entity - sale of land, (June 28, 2010) where CRA makes this comment specific to a corporation.

71. *L.I.U.N.A.*, *supra* note 6.

72. CRA Doc. No. 2002-0141145 – Non-profit organization benefits disqualify (July 31, 2002) and CRA Ruling No. 2008-0286681R3 – Payments paid by non-profit organization (2009).

73. *Hayhoe, supra* note 2;, Sherman and Arthur Drache, "Remuneration and the *Income Tax Act* | 17(1) Canadian Not-for-Profit News (Carswell) 4-5 (Jan. 2009).

74. *Otineka, supra* note 25.

75. *CRA Doc. No. 2010-0380451E5, supra* note 26.

76. *IT-496R, supra* note 2 at para 12. See also CRA Doc. No. 2003-0000215 – Non-profit organization benefit, (February 19, 2003); CRA Doc. No. 2011-0395201E5 – *IT-496R* (March 28, 2012).

77. *St Catharines Flying, supra* note 20.

78. CRA Doc. No. 2007-0221381E5 – Non-profit organization status, (February 20, 2007).

79. CRA Doc. No. 2009-0348621E5, *supra* note 26.

80. CRA Doc. No. 2010-0357831E5, s*upra* note 26.

81. *Doc. No. 2010-0380581I7, supra* note 26. But see CRA Doc. No. 2012-0433131E5 – NPO Payments to members – Section 149(1)(1) (October 23, 2012) where distribution of a surplus earned through member user fees and member buy-in fees to members was found to be offside 149(1)(1).

82. But see *CRA Doc. No. 2010-0358021E5, supra* note 68 acknowledging that NPOs can distribute deemed dividends and capital dividends.

83. *Minister of National Revenue v Lakeview Golf Club Ltd.*, [1952] Ex. CR 522 [*Lakeview Golf Club*].

84. *Ibid* at para 16 [emphasis added].

85. *Ibid* at para 18.

86. *IT-496R, supra* note 2 at 11.

87. CRA Doc. No. 2006-0194871I7 – Non-profit organization status, (August 10, 2006). See also CRA Doc. No. 2003-0036531E5 – Patronage dividends and non-profit organizations, (January 22, 2004).

88. *Moose Jaw Flying Club Ltd v Minister of National Revenue*, [1949] C.T.C. 279 (Exch Ct) [*Moose Jaw Flying*].

89. *Moose Jaw Industrialization Fund Committee Ltd v Minister of National Revenue*, 5 Tax ABC 32 [*Moose Jaw Industrialization*].

90. *L.I.U.N.A.*, *supra* note 6 at para 88 [emphasis added].

91. IT-409 – Winding-Up of a Non-Profit Organization, (February 27, 1978) (archived) at paras 2-3 [emphasis added].

92. IT-496 – Non-Profit Organizations, (February 18, 1983) (cancelled).

93. CRA Doc. No. 2001-0081575 – General information tax exempt entities, (July 6, 2001).

94. *IT-496R, supra* note 2 at para 11 [emphasis added].