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Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CRA.

Prenez note que ce document, bien qu'exact au moment émis, peut ne pas représenter la position actuelle de l'ARC.

PRINCIPAL ISSUES: In our view, does the Association qualify for the tax exemption contained in paragraph 149(1)(1) of the Act?

POSITION: No.

REASONS: The Association is operating a retail operation with the intention of earning a profit.

April 7, 2011

XXXXXXXXXX

Attention: XXXXXXXXXXXX
Directorate

HEADQUARTERS
Income Tax Rulings

L. Zannese
(613) 957-2747

2011-039425

XXXXXXXXXX

This is in response to your letter dated January 26, 2011, in which you asked for our views as to whether XXXXXXXXXXXX (the "Association") qualified for the exemption from tax contained in paragraph 149(1)(1) of the Income Tax Act (the "Act") for its 2007 to 2010 taxation years. We also acknowledge our telephone

conversations with you regarding this file (XXXXXXXXXXXX
/Zannese).

FACTS

Based on the documentation enclosed with your letter, we understand the facts to be as follows:

Articles & Memorandum of the Association:

* The Association was incorporated as a non-share corporation under XXXXXXXXXXXX of XXXXXXXXXXXX on XXXXXXXXXXXX .

* The objects of the Association are:

- o to promote employment opportunities for XXXXXXXXXXXX ;
- o to promote employment of XXXXXXXXXXXX ;
- o to operate a XXXXXXXXXXXX facility;
- o to own, rent, or lease buildings and other real or personal property necessary to undertake these objectives;
- o to manage the facilities;
- o to promote and engage in, either solely or with others, activities to assist in vocational, social and life skills trainings for XXXXXXXXXXXX ;
- o to promote the welfare of XXXXXXXXXXXX ;
- o to receive any gift in support of one or more objectives of the Association;
- o to establish and support, and to aid in the establishment and support of other associations with similar objectives;
- o to acquire any real or personal property necessary to achieve any purposes of the Association;
- o to publish newspapers, periodicals, books or leaflets;
- o to acquire any licence, privilege, power, or authority, from any government, public body or other corporation;

- o to operate and manage refreshment rooms, cafeterias and sandwich bars;
- o to acquire all necessary licences and other authority required to meet the objectives of the Association;
- o to deal in and with bills of exchange, promissory notes, or other negotiable instruments;
- o to apply the profits, if any, or other income of the Association to these objects;
- o to accept grants, aid and loans from all levels of government;
- o to receive money on deposit;
- o to subscribe or otherwise aid benevolent, charitable, national or other institutions;
- o to do all the things described above; and
- o to do all or any things authorized alone, or in conjunction, with trustees or agents.

* The first members of the Association were those individuals who incorporated the Association under provincial legislation. The directors of the Association have the right to elect members of the Association and persons nominated for membership are elected by a majority vote of the directors. Individuals may also be nominated for membership in the Association at a general meeting of the Association. An individual is elected as a member at such a meeting if a majority number of members present and voting support the individual's membership. Currently, most of the members of the Association are the original members of the board that was formed in XXXXXXXXXXXX .

* Upon dissolution of the Association, any property remaining will be transferred to another organization having objects similar to the Association. The organization receiving the property must prohibit the distribution of its income and property to members.

* The income and property of the Association must be used solely to promote the objects of the Association. No part of the income of the Association is to be paid or transferred, directly or indirectly, to the members of the Association.

However, members may receive remuneration for services actually rendered to the Association. The Association is specifically prohibited from paying out dividends to any of its members.

Activities Undertaken by the Association

* The Association began its operations as a XXXXXXXXXXXX .
XXXXXXXXXXXX .

* During this time, the Association received grants to support its operations from the XXXXXXXXXXXX as well as from the XXXXXXXXXXXX .

* Once the above-noted grants expired, the Association began incurring losses, mainly as a result of competition from other XXXXXXXXXXXX .

* As a result of these losses, the Association decided to change its operations and began a XXXXXXXXXXXX business.

* The Association continued to incur losses.

* XXXXXXXXXXXX

* XXXXXXXXXXXX

* In XXXXXXXXXXXX , it was decided that the Association would become a retail establishment.

* According to internal company reports, the Association has been profitable as a result of its conversion to a retail operation.

* The Association currently has XXXXXXXXXXXX divisions:

XXXXXXXXXXXX

XXXXXXXXXXXX

XXXXXXXXXXXX .

* The meeting minutes of the Board of Directors record that the following amounts of net income have been earned by the Association:

o Year Ending XXXXXXXXXXXX 2006 - \$XXXXXXXXXXXX

- o Year Ending XXXXXXXXXXXX 2007 - \$XXXXXXXXXXXX
- o Year Ending XXXXXXXXXXXX 2008 - \$XXXXXXXXXXXX (note this is before any donation to the XXXXXXXXXXXX ; the normal donation is \$XXXXXXXXXXXX)
- o Year Ending XXXXXXXXXXXX 2009 - \$XXXXXXXXXXXX (note this is before any donation to the XXXXXXXXXXXX ; the normal donation is \$XXXXXXXXXXXX)
- * According to the income statement and balance sheet for the Association for the year ending XXXXXXXXXXXX 2010:
 - o Net income for 2010 was \$XXXXXXXXXXXX . This includes the donation to the XXXXXXXXXXXX .
 - o The 2010 balance sheet records long term investments in the amount of \$XXXXXXXXXXXX and retained earnings of \$XXXXXXXXXXXX .
- * The Association uses its profits to XXXXXXXXXXXX through an annual donation to the XXXXXXXXXXXX as well as through the XXXXXXXXXXXX .
- * The XXXXXXXXXXXX supplies funding to organizations that XXXXXXXXXXXX
- * It was decided that for XXXXXXXXXXXX the Association will directly administer the XXXXXXXXXXXX. Organizations, including the XXXXXXXXXXXX will have to apply to receive grants.
- * XXXXXXXXXXXX
- * No income has been paid to or has been made available for the personal benefit of the members of the Association. However, large salaries have been paid to the general manager and other managers.
- * During an interview with the general manager, he indicated that the Association must operate to earn a profit each year in order to support their non-profit objectives.

Our Comments

In general terms, paragraph 149(1)(1) of the Act provides that the taxable income of an organization is exempt from tax under Part I of the Act for a period throughout which the organization meets all of the following conditions:

- * it is a club, society or association;
- * it is not a charity;
- * it is organized and operated exclusively for social welfare, civic improvement, pleasure, recreation or any other purpose except profit; and
- * it does not distribute or otherwise make available for the personal benefit of a member or shareholder any of its income, unless the member or shareholder is an association which has as its primary purpose and function the promotion of amateur athletics in Canada.

Based on the information provided, the Association is not a charity, and it has not distributed income or otherwise made income available to its members. In reviewing the Association's memorandum and articles of association, the Association appears to be organized in a manner that meets the requirements of paragraph 149(1)(1) of the Act. However, we agree with your view that the operations of the Association, although undertaken with the intent of XXXXXXXXXXXX , now evidence a profit purpose.

The Supreme Court of Canada in the decision Woodward's Pension Society v. HMQ, 62 DTC 1002 ("Woodward's"), concluded that a society incorporated for the purpose of providing funds for the payment of a pension to past employees of Woodward Stores Limited was not operated in such a manner that it qualified for the tax exemption provided by former paragraph 62(1)(i) of the Act (now paragraph 149(1)(1)). The Supreme Court of Canada noted that the society was organized for the 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. ...The appellant has entirely failed to establish that it was organized and operated exclusively for a purpose other than profit..."

Thus, an organization cannot qualify for the exemption from tax contained in paragraph 149(1)(1) if its purpose (or one of its purposes) is to earn a profit, even if that profit is used to support non-profit activities.

The Tax Court of Canada reached a similar conclusion in *Tourbec (1979) Inc. v. The Minister of National Revenue*, 88 DTC 1442, ("Tourbec"). This case involved an organization that was established with several objectives, including operating a travel agency, promoting tourism in Quebec, organizing trips and extended stays in Quebec (particularly for students and young people), co-operating with the government to promote tourism and culture in Quebec and organizing and operating inns and other places of accommodation and dining. The organization specialized in promoting travel for young persons and students between France and Canada, for which it received little or no commission.

The Tax Court of Canada concluded that Tourbec did not qualify for the exemption provided by paragraph 149(1)(1):

"What effectively happened was that Tourbec used the revenues that it received from its regular sales, that is the sales to the general public, to subsidize to a certain extent certain services that were reserved exclusively to its customers that were students and young people....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....As in 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."

In our view, the Association is operating in a manner similar to the organizations described in the Woodward's and Tourbec decisions, that is, it is operating for a profit purpose rather than earning incidental profits in the course of operating exclusively for a purpose other than profit. While it is possible for an organization to earn a profit in the course of meeting its not-for-profit objectives, and to use that profit in support of those objectives, the profit should be incidental and cannot constitute a purpose of the organization. The decision of the Federal Court in *Gull Bay Development Corporation v. HMQ*, 84 DTC 6040 ("Gull Bay") turns on this point.

Gull Bay was a corporation that was wholly-owned by the Gull Bay Indian band; its objectives included improving the social and economic conditions of members of the band. One of the key objectives of the corporation was to provide band members with job skills and training, and to this end Gull Bay established a

commercial logging operation that would provide employment to band members. The commercial logging operation earned a profit, however, the Federal Court found the corporation to be exempt from tax under paragraph 149(1)(1) of the Act because earning a profit was not a purpose of the corporation:

"The social and welfare activities of the plaintiff are not a cloak to avoid payment of taxation on a commercial enterprise but are the real objectives of the Corporation."

The Association may have, at one time, fit within the parameters of the Gull Bay decision (although this is not clear); in any event, this is no longer the case. The profit earned by the Association is no longer incidental to its otherwise not-for-profit activities; instead, the Association appears to be a for-profit enterprise, operating in direct competition with taxable businesses, within the guise of a not-for-profit organization. Although the Association's ultimate aims may be laudable, it has a profit purpose and does not qualify for the exemption from tax provided by paragraph 149(1)(1) of the Act. In this it is no different from any for-profit business that decides to provide its profits to a worthwhile cause; such a business is only eligible for a reduction in tax to the extent that the donation is a gift to a registered charity (or other eligible donee) and a charitable donation receipt is obtained.

To expand on the comments above, the fact that its profits are earmarked for a worthwhile cause does not make an entity exempt from tax. We note that this "destination of funds" test has been rejected on several occasions by the courts for both charities and not-for-profit organizations. Most recently, the Tax Court of Canada in *BBM v. HMQ*, 2008 TCC 341 commented:

"The Crown's position is that an entity will be established and operated for a purpose other than profit only if its income is used to advance a public purpose of some sort. It does not seem appropriate for the Court to add a destination of funds test or requirement to discern purpose as advocated by the Crown. The Federal Court of Appeal rejected a destination of funds test for discerning qualifying purposes of charitable organizations in *Earth Fund v. M.N.R.*, 2003 DTC 5016 (F.C.A.). Justice Bowman, as he then was, rejected a destination of funds test in *Otineka Development Corporation Limited v. H.M.Q.*, 94 DTC 1234 (T.C.C.), at 1237, for discerning qualifying purposes of not-for-profit entities. The Supreme Court of Canada had earlier done the same in *M.N.R. v. St. Catharines Flying Training School Ltd.*, 55 DTC 1145. See also *Gull Bay Development Corporation v. H.M.Q.*, 84

DTC 6040 (F.C.T.D.), and *Tourbec (1979) Inc. v. M.N.R.*, 88 DTC 1439 (T.C.C.). If a destination of funds test is not a bright line test to qualify for charitable purposes or to qualify for not-for-profit tax-exempt status, it is not obvious to me why it should be for disqualifying non-profit entities of tax-exempt status.

...

"It is clear from such cases as *Woodward's Pension Society*, *Otineka*, and *Tourbec* that an entity cannot qualify for the paragraph 149(1)(1) 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."

We understand from the documents provided and from our conversations with you that the XXXXXXXXXXXX . You have asked us to comment on the application of CBIA for the taxation years under review. To the extent that the comments in CBIA are applicable to the Association's situation for the taxation years currently under review, we are of the view that they tend to support the conclusion that the Association is a for-profit organization. In CBIA, the court accepted that CBIA did not have a profit purpose on the basis that CBIA's involvement in commercial and investment activities was directly connected to its not-for-profit objective of providing insurance at cost to members (the nature of the organization as an insurer was relevant). In contrast, the Association is earning significant profits from activities that no longer appear to be directly connected to its not-for-profit objectives. In particular, it is difficult to see how the XXXXXXXXXXXX operations, as described, are connected to the Association's original objective of promoting "employment of XXXXXXXXXXXX .

In conclusion, in our view, the Association likely did not qualify for the exemption from tax pursuant to paragraph 149(1)(1) of the Act for the taxation years under review. The scope of the profitable activities of the Association and the lack of connection between these activities and the not-for-profit objectives of the Association indicate that the

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Association has a profit purpose as well as not-for-profit purposes. XXXXXXXXXXXX .

We trust that these comments will be helpful to you. Please contact us if we may be of further assistance.

Yours truly,

Eliza Erskine
Manager
Non-Profit Organizations and
Aboriginal Issues
Financial Sector and Exempt Entities Division
Income Tax Rulings Directorate
Legislative Policy and Regulatory Affairs Branch