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DOCNUM 2010-0380581I7
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DESCKEY 26
RATEKEY 2
REFDATE 110407
SUBJECT Paragraph 149(1)(1) of the Income Tax Act
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PRINCIPAL ISSUES: 1. Can an unregistered charity qualify for a tax exemption provided by paragraph 149(1)(1)? 2. Is an organization restricted to certain activities or objectives in order to qualify for this tax exemption? 3. Can such an organization fundraise and continue to qualify for an exemption from tax?

POSITION: 1. No. 2. No, but cannot have any profit purpose. 3. Incidental profits, basic fundraising (lotteries, bake sales, chocolate bar sales etc.), soliciting gifts and grants allowed.

REASONS: 1. Wording of paragraph 149(1)(1) - organization cannot be "charity". 2. The provision does not restrict an organization to a particular activity or objective, only to a lack of profit purpose. 3. Organization must operate "exclusively" for purposes other than profit; incidental profits do not amount to profit purpose.

April 7, 2011

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Paragraph 149(1)(1) of the Income Tax Act

We are writing in response to your email dated September 14, 2010, in which you asked several questions regarding the tax exemption provided by paragraph 149(1)(1) of the Income Tax Act (the "Act"). Specifically, you requested confirmation that an organization cannot qualify as a 149(1)(1) organization if it is a charity, regardless of whether or not it is a registered charity. Further, you asked whether an organization can be denied this tax exemption based on its objects and activities. You also asked whether an organization can be denied this exemption if the purpose of the organization is to fundraise.

Our Comments

In general, 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, within the meaning assigned by paragraph 149.1(1) of the Act;
- * 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.

Since the exemption applies to a "period" throughout which an organization meets the above conditions, the tax status of an organization must generally be reviewed on a year to year basis. However, an exempt or taxable period could be shorter than a year; for example, subsection 149(6) of the

Act allocates income between exempt and taxable periods within a taxation year for organizations that are not incorporated.

An organization will not qualify for the exemption provided by paragraph 149(1)(1) of the Act if the organization is a charity, even if it is not a registered charity. Thus, we confirm your understanding that organizations with exclusively charitable purposes do not qualify for the tax exemption provided by paragraph 149(1)(1).

Paragraph 149(1)(1) of the Act does not restrict an organization to any particular purpose or purposes in order to qualify for the tax exemption; any purpose is allowed other than a profit purpose. Unlike a charitable organization, which must devote its resources exclusively to its charitable purposes, a 149(1)(1) organization can undertake any activity except to the extent that the scope of the activity indicates that the organization has a profit purpose (as well as not-for-profit purposes). There is no requirement for a 149(1)(1) organization to have a "benevolent" or "social" purpose.

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 has any profit purpose, the activities of the organization must be reviewed both independently and in the context of the organization as a whole.

For an example of a situation in which the court found profits from business activities to be incidental to the organization, see the Federal Court Trial Division decision in *Gull Bay Development Corporation v. HMQ*, 84 DTC 6040. In this decision, the court held that the purpose of a logging operation was exclusively to provide employment and training opportunities to members of a First Nations band, and to support the general socio-economic development of the band's community. The decision in *Tourbec (1979) Inc. v. MNR*, 88 DTC 1442 (TCC) discusses the opposite situation, where the profitable activities were found to be a purpose of the 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). In all of these cases, the profitable activities are directly in support of not-for-profit objectives - providing appropriate

facilities, promoting participation in music - and will generally be incidental in terms of the amounts involved and the scope of the activities compared to the operations of the organization as a whole.

An organization will not be exempt from tax pursuant to paragraph 149(1)(1) 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)(1) organizations.

We trust that these comments will be of assistance.

Yours truly,

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