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SUBJECT Non-Profit Organization - Lottery Revenue

SECTION 149(1)(l)

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: Whether the lottery income received by the Association is subject to taxation in the hands of the Association.

POSITION: Likely yes.

REASONS: It does not appear that this income is incidental or arises from activities directly connected to its not-for-profit objectives, which is to support physical and recreational activities as a way of life in XXXXXXXXXXXX.

XXXXXXXXXX

2014-053435

Ananthy Mahendran

(905) 721-5204

November 18, 2014

Dear XXXXXXXXXXXX:

Re: Non-Profit Organization – Lottery Revenue

This is in response to your email of August 6, 2014, requesting our comments on the application of paragraph 149(1)(l) of the Income Tax Act (the "Act") to XXXXXXXXXXXX ("the Association").

As we understand it, the Association is a non-profit organization incorporated under the XXXXXXXXXX Societies Act. It provides funding and supports to imbed physical activity as a way of life in XXXXXXXXXX, for all. Funding for physical and recreation activity priorities is derived from the sale of XXXXXXXXXX products (Lotto 6/49, Lotto Max, Pro-line and Scratch n Win tickets) through XXXXXXXXXX retail outlets across XXXXXXXXXX. The proceeds of lottery products are returned to the Association. After deducting expenses incurred to sell the lottery products, the Association generates a net profit. You are concerned that the Association may not currently be operated exclusively for purposes other than profit, which is required for exemption from tax pursuant to paragraph 149(1)(l) of the Act.

Specifically, you have asked for our comments in relation to the following questions:

1. Whether the lottery revenue received by the Association is subject to taxation in the hands of the Association.
2. If none of the profits from the lottery sales is retained by the Association, can the Association maintain its eligibility as a non-profit organization under paragraph 149(1)(l) of the Act?

Our Comments:

This technical interpretation provides general comments about the provisions of the Act and related legislation. It does not confirm the income tax treatment of a particular situation involving a specific taxpayer but is intended to assist you in making that determination. The income tax treatment of particular transactions proposed by a specific taxpayer will only be confirmed by this Directorate in the context of an advance income tax ruling request submitted in the manner set out in Information Circular IC 70-6R6, Advance Income Tax Rulings and Technical Interpretations.

In order to qualify as a non-profit organization (NPO) within the meaning of paragraph 149(1)(l) of the Act, an organization must meet 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
- * its income is not available for the personal benefit of a member or shareholder.

An organization will not be exempt from tax under paragraph 149(1)(l) of the Act if earning profits is a purpose of the organization. If an organization sells goods or performs services to earn income, it may be considered to have a profit purpose, even if the income is used in furtherance of the organization's not-for-profit objectives. Neither the Canada Revenue Agency (CRA) nor the courts accept that using profits to finance not-for-profit objectives is sufficient in and of itself to deny a profit purpose. If an organization wishes to carry on a for-profit business for the purpose of providing funds to an NPO, the business should be carried on through a taxable entity and the funds provided to the NPO on an after-tax basis.

Jurisprudence has established that engaging in profit-generating activities will not necessarily preclude an organization from satisfying the requirements of paragraph 149(1)(l) of the Act provided that the earning of the profit has not, itself, become an objective of the organization. Therefore, it needs to be first determined whether the particular activities in which the Association engages are carried out on a for-profit or not-for-profit basis. As we understand it, the Association generates a net profit from the sale

of the lottery products. This profit-generating activity may possibly affect the tax exempt status of the Association, if the earning of the profit is or has become an objective of the Association.

The CRA has accepted that an organization claiming an exemption under paragraph 149(1)(l) of the Act can earn a profit, as long as the profit is incidental and arises from activities directly connected to its 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. Where an organization does not meet these conditions, the organization would no longer qualify for the tax exemption provided for in paragraph 149(1)(l) and would therefore be considered a taxable organization.

Generally, fundraising, by its very nature, is considered a profit activity. However, the CRA accepts that certain fundraising activities can be carried on directly by a 149(1)(l) entity without jeopardizing its tax-exempt status. 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. However, the scope of the fundraising activities, especially by comparison with other activities, should not be so significant that fundraising can be considered a purpose of the organization, in which case the organization may not qualify as a 149(1)(l) entity.

Based on the facts provided, it is our view that the lottery income generated by the Association could affect the tax-exempt status of the Association since it does not appear that this income is incidental or arises from activities directly connected to its not-for-profit objectives, which are to support physical and recreational activities as a way of life in XXXXXXXXXX. Whether the amount of income is considered incidental in relation to the needs of the Association to carry on its non-profit activities is a question of fact to be determined with regard to the Association's particular circumstances.

With respect to your second question, 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 CRA and the courts on numerous occasions for 149(1)(l) organizations. For purposes of paragraph 149(1)(l) exemption, the destination of the profits does not remediate the disqualifying pursuit of a profit purpose. In your particular situation, even if none of the profits from the lottery sales is retained by the Association, it is our view that the Association may still have a profit purpose and, as such, would not qualify for the exemption under paragraph 149(1)(l) of the Act. Also, in such a situation, the income earned by the Association, for example administration fees or commission income, can still be an issue if it is not incidental and is unrelated to the Association's not-for-profit objectives.

We trust that these comments will be of assistance.

Yours truly,
Roger Fillion, CPA, CA
Manager
Non-Profit Organizations and Aboriginal Issues
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