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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 NPO meets the requirements of paragraph 149(1)(l).

POSITION: Likely no.

REASONS: Fact specific.

November 20, 2012

Small & Medium Enterprises Directorate HEADQUARTERS

112 Kent Street, 19th Floor Income Tax Rulings

Ottawa, ON K1A 0L5 Directorate

Lori Merrigan

(613) 957-9229

Attention: Gilles Rochette

2012-043995

XXXXXXXXXXXX (the "Association")

This is in response to your correspondence of March 15, 2012, asking for our comments with respect to the tax-exempt status of the Association pursuant to paragraph 149(1)(l) of the Income Tax Act (the "Act").

FACTS

These are the facts as we understand them:

? The Association is a XXXXXXXXXXXX association that was created in the year XXXXXXXXXXXX.

? Sources of revenue are: sponsorships, membership fees, event fees, XXXXXXXXXXXX, and interest on loan to a taxable subsidiary.

? Excess revenue over expenditures has been \$XXXXXXXXXXXX for the taxation years XXXXXXXXXXXX, respectively.

? The capital reserve account balance has accumulated to more than XXXXXXXXXXXX years of expenditure coverage. The capital reserve account consists of unrestricted and restricted amounts:

Year XXXXXXXXXXXX

Unrestricted \$XXXXXXXXXXXX

Other restricted \$XXXXXXXXXXXX

In XXXXXXXXXXXX, the Association acquired the XXXXXXXXXXXX (the "Subsidiary") through XXXXXXXXXXXX. Subsequently, the XXXXXXXXXXXX amalgamated with the Subsidiary, with the Subsidiary being the taxable successor corporation.

? Funds from the unrestricted capital reserve account of the Association were used to make the \$XXXXXXXXXXXX investment in the taxable Subsidiary. This investment amount was recorded on the

XXXXXXXXXX balance sheet of the Association as follows:

Common shares \$XXXXXXXXXX

Equity in earning since purchase (for one month) \$XXXXXXXXXX

Non-interest bearing loan \$XXXXXXXXXX

Interest bearing loan \$XXXXXXXXXX

The principal balance of the interest bearing loan bears interest as XXXXXXXXXXXX.

? It is unclear whether the reserves accumulated from an increase in member fees.

? After a series of transactions between the Association and the Subsidiary, by the end of the year XXXXXXXXXXXX, the Subsidiary owed the sum of \$XXXXXXXXXX to the Association.

? Every year the Association and Subsidiary report interest revenue and expense respectively. This is not a cash transaction and the accrued interest revenue earned has been added to the balance of the previous period non-interest-bearing loan to the Subsidiary.

ANALYSIS

In order for the Association to qualify as a 149(1)(l) entity it must be organized and operated exclusively for any purpose other than profit. However, 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.

Based on the facts available, the excess revenues in comparison to expenditures for the Association for the XXXXXXXXXXXX years appear to be somewhat consistent and material. This suggests there may be a profit purpose.

The large reserves (nearly \$XXXXXXXXXX in XXXXXXXXXXXX) might also indicate that there is an accumulation of income for the purpose of earning investment income, which could also indicate a profit purpose. As stated in paragraph 8 of Interpretation Bulletin IT-496R, "Non-Profit Organizations", an organization that retains excess funds in order to invest them and earn income is not considered to be operating exclusively for a purpose other than profit.

Additionally, the large reserves might also be for the purpose of increasing capital within the Association. A 149(1)(l) entity may fund capital projects, however, those projects should be identified and funded by capital contributed by members, from gifts and grants, or from accumulated, incidental profits.

In our view, the large amount of reserve funds could not have been accumulated through incidental profits. Further, the investment in the Subsidiary for \$XXXXXXXXXXXX was made from the unrestricted capital reserve account of the Association, which suggests that the large reserves may be unnecessary for the purpose of carrying out its not-for-profit activities and may be accumulated for profit purposes.

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 organization 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.

CONCLUSION

In our view, the fact that the Association has sufficient funds available to purchase and finance a taxable organization, whether the objects of that organization are connected to the objects of the Association or not, suggests that the Association has not been organized and operated for a purpose other than profit and thus does not meet the requirements of paragraph 149(1)(l) of the Act. Further, in our view, the amount of reserves and annual excess of revenues over expenditures, also support that the Association does not meet those requirements.

For your information, unless exempted, a copy of this memorandum will be severed using the Access to Information Act criteria and placed in the Canada Revenue Agency's electronic library. A severed copy will also be distributed to the commercial tax publishers for inclusion in their databases. The severing process will remove all material that is not subject to disclosure, including information that could disclose the identity of the taxpayer. Should the taxpayer request a copy of this memorandum, they may request a severed copy using the Privacy Act criteria, which does not remove taxpayer identity. Requests for this latter version should be made by you to Mrs. Celine Charbonneau at (613) 952-1361. In such cases, a copy will be sent to you for delivery to the taxpayer.

Yours truly,

R.A. Albert, CA

Manager

Non-Profit Organizations and Aboriginal Issues Section

Business and Employment Division

Income Tax Rulings Directorate

Legislative Policy and Regulatory Affairs Branch

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