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Ministère des Finances  
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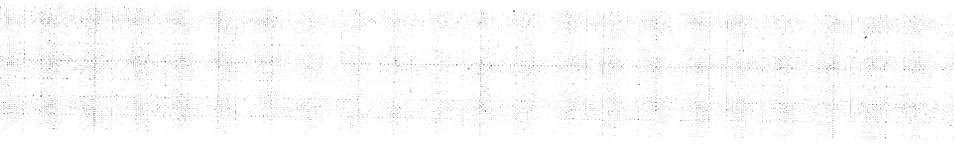
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3120-001	
Your file	Votre référence
2011FIN356498	
Date	
	OCT 19 2011

SUBJECT  
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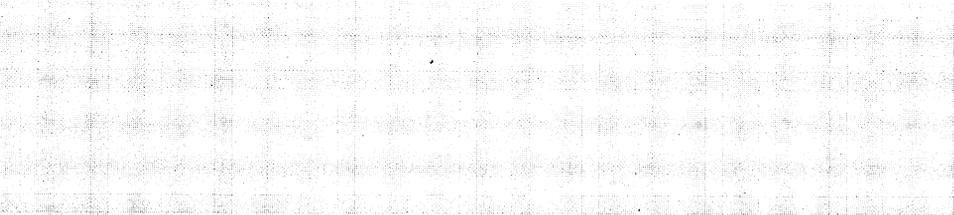
Tax Treatment of Non-Profit Organizations and other Tax-exempt Entities



Due to the wide variety of tax-exempt entities that exist, this note provides only a general description of their tax treatment, with particular emphasis on non-profit organizations and charities. It also reviews some of the main emerging tax-related issues with respect to this sector.

**Summary**

- A wide variety of entities are exempt from tax under the Income Tax Act (ITA).



**Background**

**Tax-Exempt Entities**

Under the Income Tax Act (ITA) a wide variety of entities are exempted from paying tax on their income. These exemptions apply to entities such as Crown and municipal corporations, non-profit organizations, registered charities, registered Canadian amateur athletic associations, registered savings plans, labour organizations and certain low-income housing corporations (a

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s.18(d)  
s.21(1)(b)

Canada

full list of tax-exempt entities is provided in Annex A).<sup>1</sup> A number of these exemptions have existed since the introduction of the Income War Tax Act in 1917<sup>2</sup>, but the list has been expanded over the years for differing policy reasons.

Generally speaking, where an organization meets the definition of a particular type of exempt entity, all of its income-earning activities are tax-exempt.<sup>3</sup> The ITA does not usually restrict the type of income-earning activities in which an exempt entity may engage, but the definition of the exempt organization may itself limit an entity's business activities. For example:

- a non-profit corporation constituted exclusively for scientific research and experimental development purposes<sup>4</sup> by definition may only engage in activities relating to its purpose; and
- a mutual insurance corporation<sup>5</sup> would be tax-exempt only if it received its premiums entirely from the insurance of churches, schools or other charitable organizations.

Annex A provides a general overview of the business activities which may be carried on by these entities on a tax-exempt basis.

The majority of tax-exempt entities are not required to register with the Canada Revenue Agency (CRA) in order to qualify for exemption from income tax. Instead, most simply self-identify as being within one or more of the exempt categories and, if required to file a return, file as an exempt organization.<sup>6</sup>

- In other instances, entities may be required to maintain some form of registration with the CRA as a condition of qualifying for their tax exemption. This includes, for example, registered charities, registered Canadian amateur athletic associations, and registered retirement savings plans. Registration is often required where there is a heightened risk of abuse, either to the tax system or the public, and is tied to more robust regulatory rules (including enhanced reporting requirements), enabling the CRA to more closely monitor the activities of particular entities to ensure compliance with the ITA.

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<sup>1</sup> In certain circumstances, individuals, such as employees of the government of another country required to reside in Canada, are also exempted from paying income tax in Canada. For simplicity, this note refers only to exempt entities. In addition, this note does not discuss co-operatives or credit unions

as they are not classified as tax-exempt organizations.

s.21(1)(b) <sup>2</sup> For example, in that Act exemptions were provided for municipal corporations, labour organizations, charities and NPOs.

<sup>3</sup> While the ITA permits income to accumulate in these entities on a tax-exempt basis, the income is often taxed later in the hands of another person. This result applies, for example, to registered pension plans (RPPs), registered retirement income funds (RRIFs) and registered retirement savings plans (RRSPs).

<sup>4</sup> Described under s.149(1)(j).

<sup>5</sup> Described under s.149(1)(m).

<sup>6</sup> While the particular filing requirements can vary depending on the type of exempt organization, if the tax-exempt entity is a corporation it must file an income tax return. Not all exempt organizations are established as corporations, for example, a non-profit organization may be constituted as an unincorporated association.

To be eligible for a tax exemption, an entity must meet the criteria for that exemption on an annual basis. The CRA may review the activities of a tax-exempt entity for any particular taxation year and, where it does not meet the relevant criteria, the entity would be subject to tax on any income earned during that year, plus any applicable interest. Additionally, where an entity becomes tax-exempt during a year, ITA rules require that any capital gains or losses be recognized; where an entity ceases to be tax-exempt it is also treated at that point as having acquired all of its property at fair market value – in order to establish a basis for computing its income going forward.

### Non-Profit Organizations

One of the largest categories of tax-exempt entities is that of non-profit organizations (NPOs). An NPO can generally be described as a club, society or association that is organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit, but is not a charity as defined in the ITA. The NPO definition is intentionally broad and would typically include fraternal organizations, professional societies, condominium corporations, recreational clubs, and organizations intended to advance the educational standards within an industry or profession.

s.21(1)(b) NPOs receive tax-exempt status in recognition of the special role that they play in society – often filling a gap between the private and the public sector. This role is exemplified in the work done by organizations like  . Generally, the activities of NPOs are expected to be directed toward a mutual or broad community goal rather than individual gain. Although NPOs are often formed to pursue the mutual goals of their membership, the ITA prohibits any part of their income (other than taxable capital gains) from being payable or otherwise available for the personal benefit of their proprietors, members or shareholders.

Although other countries also provide NPOs with preferential income tax treatment, Canada's treatment is particularly generous. Unlike many countries, for example, Canada does not tax any unrelated business income, income from non-members, or passive income earned from the NPO's surplus.<sup>7</sup>

Like other tax-exempt entities, an NPO is not required to register with the CRA, but may be required to file either an income tax return or an NPO Information Return.<sup>8</sup> If it ceases to operate as an NPO (i.e., if it operates for the purpose of profit) and does not qualify for any other category of exemption, it would be subject to tax on its annual income.

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<sup>7</sup> For example, income from an unrelated business could include an NPO earning income from renting out a dedicated portion of its facilities to a commercial enterprise (e.g., a coffee shop); income from non-members could include payments received from guests at a recreational club; and exempt passive income could include the returns on an NPO's reserves.

<sup>8</sup> An NPO must file an income tax return if it is a corporation, it receives investment income of \$10,000 or more in a year, has assets in excess of \$200,000 or has been required to file in the past because it met the investment income or asset tests.

### **Charities and Other Qualified Donees**

Another large category of tax-exempt organizations is that of registered charities. There are approximately 85,000 registered charities across Canada. In addition to exemption from tax, registered charities are given the privilege of issuing official donation receipts for gifts which may be used by individuals and corporations to claim tax credits or deductions against their income. Tax expenditures associated with charitable donations were approximately \$2.7 billion in 2010.

The ITA also provides the authority to issue official donation receipts to certain other "qualified donees". Qualified donees include:

1. registered Canadian amateur athletic associations (RCAAs);
2. registered national arts service organizations (RNASOs);
3. the United Nations or an agency thereof;
4. federal, provincial, and territorial governments;
5. municipal governments and municipal or public bodies performing a function of government (such as certain provincial corporations, First Nations and Aboriginal self-governments, school boards, public transit authorities);
6. housing corporations in Canada constituted exclusively to provide low-cost housing to the aged;
7. universities outside of Canada the student body of which ordinarily includes students from Canada; and,
8. certain other charitable organizations outside of Canada who have received a gift from Her Majesty.

Regulatory provisions in the ITA differ among qualified donees and, prior to Budget 2011, most were unregulated. However, recent non-compliance highlighted the need to tighten rules for qualified donees and in Budget 2011 changes were announced which will give the CRA authority to regulate the activities of these entities, particularly with respect to the issuance of official donation receipts (see Annex B).<sup>9</sup>

The regulatory regime for charities is considerably more robust than that for other exempt entities and a number of limits are placed on their activities. This is, in part, because the common law definition of charity requires charities to operate in an altruistic manner for the benefit of the broader public. However, this regulatory regime also helps to ensure that the tax incentives for charitable giving are not abused for private purposes, and to enable Canadians to give to charities with confidence that their donations will be put to charitable use. The key rules for charities include:

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<sup>9</sup> The changes announced in Budget 2011 do not apply to the federal and provincial governments or the United Nations and its agencies.

- *Requirement to operate exclusively for "charitable purposes".* Registered charities are required to be established for exclusively charitable purposes and devote their resources exclusively to those purposes.<sup>10</sup>
- *Increased public transparency.* The annual information returns filed by registered charities are publicly available on the CRA website.
- *Restrictions on gifts of resources.* Registered charities are permitted to make gifts of their assets, but only to other qualified donees.
- *Limited political activities.* Registered charities may only carry on political activities which are limited (generally to a maximum of ten per cent of their resources), non-partisan and related to their objectives; and
- *No undue benefits.* Registered charities are prohibited from providing undue benefits to any person (e.g., paying unreasonably-high compensation to an employee or contractor).

#### Restrictions on Business Activities

In addition to the above restrictions, the ITA restricts the business activities of charities to "related businesses" – i.e., those that directly relate to the fulfillment of their charitable purposes. The CRA administrative guidance describes a related business as one that is:

- a usual and necessary concomitant of a charitable program (e.g., a cafeteria at a hospital or a book store at a university); or
- an off-shoot of a charitable program (e.g., an orchestra, in addition to hosting performances, sells CDs to the public).

In addition, some charitable activities that have a business element are considered acceptable. This includes "training businesses" that provide on-the-job training to the under-employed or hard to employ and "social businesses" that employ the disabled.

Any registered charity which does not comply with the regulatory rules may be subject to monetary penalty,<sup>11</sup> a temporary suspension of its receipting privileges, or the revocation of its registered status. Where a charity's registration is revoked, it has one year to dispose of its assets (either on charitable activities or as gifts to other charities) or it must pay a 100 per cent tax on any assets which remain.

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<sup>10</sup> Charitable purposes have been defined through a considerable body of common law and are categorized into four headings: the relief of poverty, the advancement of education, the advancement of religion and certain other purposes recognized by the courts as charitable (e.g., the promotion of health or protection of the environment).

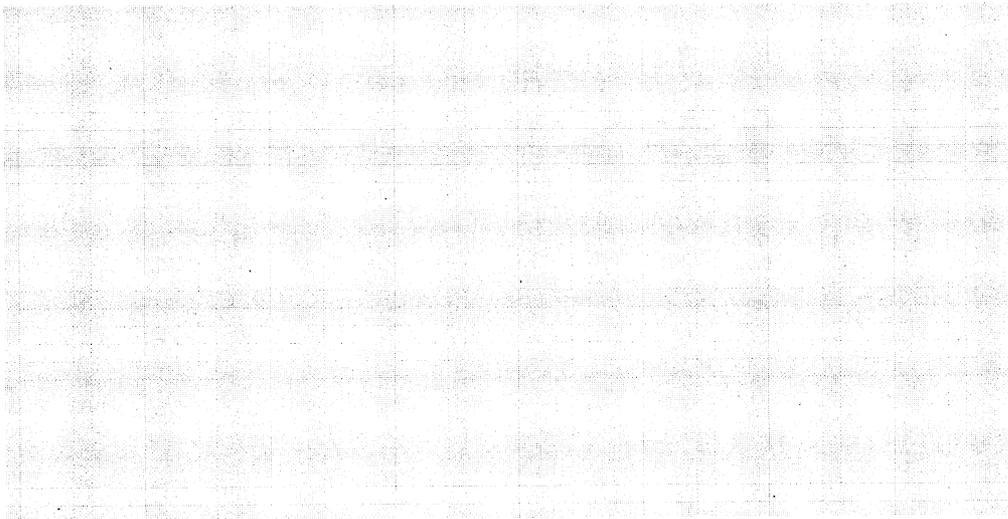
<sup>11</sup> The penalties for charities are found at s. 188.1 of the ITA and vary depending on the infraction. These can often be quite significant – the penalty for a charity carrying on an unrelated business, for example, is 100 per cent of the gross revenue of that business on its second infraction.

**GST/HST and Excise Tax Relief for Charities and NPOs**

Registered charities, RCAAs and NPOs are also provided tax relief from the Goods and Services Tax/Harmonized Sales Tax (GST/HST) and the federal excise tax on gasoline.

Under the GST/HST, most services and many goods supplied by registered charities and RCAAs are exempt from GST/HST meaning that they are not required to charge the tax on most of their sales. A more limited range of goods and services are GST/HST-exempt when supplied by NPOs (e.g., children's recreational programs and goods not exceeding \$5 supplied during volunteer fund-raising activities). All registered charities, RCAAs and qualifying NPOs (i.e., those NPOs that receive at least 40 percent of their funding from government) are also entitled to a rebate of 50 percent of the GST they pay on inputs used in the provision of their exempt sales. The rebate was intended to reduce the additional costs the GST would impose on them, while maintaining a level of competitive equity with those providing similar services but do not qualify for the rebate. (Rebates of the provincial component of the HST also apply at rates set by individual HST provinces.) In addition, a refund of part of the federal excise tax on gasoline can be claimed, at the rate of 1.5 cents per litre, on purchases by registered charities and RCAAs.

This GST/HST and gasoline excise tax relief, when applicable, relies on the definitions of a registered charity and a RCAA in the ITA. NPOs are also defined similarly for ITA and GST/HST purposes. Accordingly, changes to any ITA provisions affecting whether an entity qualifies as a registered charity, RCAA or NPO, or changes affecting the activities they can carry on, could have consequences for their entitlement to certain GST/HST and gasoline excise tax relief.



s.18(d)  
s.21(1)(a)  
s.21(1)(b)