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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: Will a corporation that is being incorporated under provincial non-profit legislation be tax-exempt under paragraph 149(1)(1) of the ITA?
POSITION: Question of fact; general comments provided.
REASONS: Whether an entity qualifies for the tax exemption can only be determined once the entity is established, has been operating and has filed a tax return.

XXXXXXXXXX

VIA FAX: XXXXXXXXXXXX 2010-036605
L. Zannese
(613) 957-2747

May 11, 2010

Dear XXXXXXXXXXXX :

Re: Income Tax Exemption for Non-Profit Organizations

We are writing in response to your fax dated April 24, 2010, which we received on April 28, 2010, requesting information on the application of paragraph 149(1)(1) of the Income Tax Act (the "Act"), that is, information on whether a particular, proposed corporation could be a tax-exempt "non-profit organization" for Canadian tax purposes. We also acknowledge our telephone conversations with you (Erskine/XXXXXXXXXX) regarding your inquiry.

You have provided us with the following information:

- * Certain people may incorporate a membership corporation in the province of XXXXXXXXXXXX as a provincial "non-profit organization".
- * The members of the corporation may include XXXXXXXXXXXX .
- * There may be voting and non-voting ("affiliate") members.
- * The corporation will not make available any of its income to its members.
- * Upon the winding-up of the corporation, any assets the corporation has will be distributed to another non-profit organization.

The proposed corporation will be undertaking activities such as:

XXXXXXXXXX

In addition, you advise that a donor wishes to donate various assets to the corporation, but may only do so if there is no tax liability. The assets that the donor is considering donating include:

- * cash in the amount of \$XXXXXXXXXX Canadian;
- * XXXXXXXXXXXX ;
- * XXXXXXXXXXXX ;
- * XXXXXXXXXXXX ; and
- * XXXXXXXXXXXX .

The corporation intends to invest the cash donated to it to provide income which will be used by the corporation exclusively to pay for its cultural activities and various related operations.

The situation outlined in your fax is a factual one, involving a specific group of taxpayers. This Directorate cannot provide confirmation of the tax implications of a proposed transaction involving specific taxpayers other than in the form of an advance income tax ruling. Where available, the advance income tax ruling service requires payment of an hourly fee (including a deposit in advance), and full submissions must be provided, usually by the taxpayer's advisor. In any event, as explained to you in our telephone conversations, we cannot provide you with an advance income tax ruling or other binding assurance in the situation that you describe. The determination of whether any organization qualifies absolutely for the tax exemption provided by paragraph 149(1)(1) of the Act can only be made after the organization has been established and has been in operation during a taxation year; in other words, this is a

determination that can only be made after the fact. Moreover, this determination can only be made by the appropriate Tax Services Office. Although we cannot provide you with a definite answer with respect to your specific situation, we are prepared to provide the following general comments, which may be of assistance.

Comments

Paragraph 149(1)(1) of the Act (set out below), provides an exemption from tax for organizations that meet certain criteria. The term "non-profit organization" does not have a specific meaning for federal income tax purposes; the Act does not define or use the term "non-profit organization". However, we understand that it is common to refer to organizations qualifying for this tax exemption as "non-profit organizations". Unfortunately, this can lead to confusion, as it means that an organization can be incorporated by a federal or provincial statute that uses the term "non-profit organization" (or something similar), but still not qualify for the tax exemption. In other words, the method of creating the organization does not affect whether the organization qualifies for the tax exemption. The tax exemption only applies if all the required conditions of paragraph 149(1)(1) are met, no matter how the organization is otherwise described or how it is set up.

Paragraph 149(1)(1) of the Act provides an exemption from income tax for

"...a club, society or association that, in the opinion of the Minister, was not a charity within the meaning assigned by subsection 149.1(1) and that was organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit, no part of the income of which was payable to, or was otherwise available for the personal benefit of, any proprietor, member or shareholder thereof unless the proprietor, member or shareholder was a club, society, or association the primary purpose and function of which was the promotion of amateur athletics in Canada;"

The key elements of this income tax provision are as follows:

- * the organization must not be a charity;
- * it must be organized and operated exclusively for a purpose other than profit; and
- * its income cannot be payable to or made available for the benefit of its members.

In our view, based on the facts you have given us, the proposed corporation will not qualify for the tax exemption provided by paragraph 149(1)(1) of the Act. This is because the corporation intends to use the cash donation (or other assets) to earn investment income in order to support its activities. We understand that all of the income of the corporation will be used to fund the cultural and other activities of the organization. However, the activity of investing cash (or other assets), is generally considered to be undertaken specifically to earn a profit, which is contrary to the conditions of paragraph 149(1)(1). The only exception to this is where cash or other income-generating assets will themselves be used directly to meet an organization's not-for-profit objectives within a reasonable time-frame - in other words, the expectation is that the capital property will either be spent or used directly, within the foreseeable future, on not-for-profit objectives. It is not enough that income will be used to meet the organization's not-for-profit objectives; maintaining capital property for the purpose of generating income for the organization means that the organization has a profit purpose among its other purposes. The Canada Revenue Agency ("CRA") takes this position based on the words of paragraph 149(1)(1) and various court cases interpreting that provision.

Relating our comments above to the facts you have given us, we note that if the XXXXXXXXXXXX property is used directly in furthering your organization's not-for-profit objectives - for example, if activities take place specifically at the XXXXXXXXXXXX , and the XXXXXXXXXXXX property is not intentionally used to generate a profit - then simply owning the XXXXXXXXXXXX property in no way prevents your organization from being tax-exempt under paragraph 149(1)(1) of the Act. As we discussed in our telephone conversations, a non-profit organization can own capital assets required for its needs and remain tax-exempt. However, maintaining a large amount of capital (in this case, cash) solely for the purpose of generating income to support your organization will prevent your organization from being tax-exempt under paragraph 149(1)(1).

We understand that your proposed organization may have very worthwhile objectives. Unfortunately, the tax exemption available under paragraph 149(1)(1) of the Act is not determined by the nature of an organization's objectives. Because paragraph 149(1)(1) can apply to any organization, even one organized primarily for business purposes, its conditions must be strictly applied. There are other provisions in the Act that focus specifically on the nature of an organization (that is,

what the organization does), in order to determine if a tax exemption applies. For example, paragraph 149(1)(i) of the Act applies to organizations that provide certain low-cost housing to the aged, paragraph 149(1)(k) of the Act applies to labour organizations, and paragraph 149(1)(f) of the Act applies to registered charities. We note that an organization can only be a charity if it has certain, very restricted, objectives. Your organization does not appear to be a charity for purposes of the Act, however, as discussed in our telephone conversations, we will not review the taxation of charities (which includes private foundations) in this letter.

We note that the discussion above represents a non-binding, preliminary view of the tax status of the proposed corporation. In the event that we have misunderstood the situation, or that the facts change, we would like to point out other issues that you may wish to consider or discuss with your tax adviser.

There is a special rule that applies to an organization that is tax-exempt under paragraph 149(1)(l) of the Act, if the organization provides dining, recreational or sporting facilities to its members. This special rule effectively taxes the investment or other property income of the organization (including some capital gains), even though the organization is otherwise tax-exempt. This means that even if your proposed corporation does qualify for the tax exemption, its investment income (that is, on the cash and other assets), may be taxable if the corporation is considered to be providing recreational facilities to its members.

You have also asked us for information about what would happen, for tax purposes, if the donated XXXXXXXXXXXX property were sold by the proposed corporation. If the proposed corporation qualified for the tax exemption under paragraph 149(1)(l) of the Act, then the corporation would not be taxable on any capital gain generated by the sale of the XXXXXXXXXXXX property. This would be true even if the corporation was found to be providing recreational facilities, as long as the XXXXXXXXXXXX property was being used by the corporation exclusively for and directly in providing the recreational facilities to its members.

We regret we cannot provide you with a definitive answer. However, we hope that this information is helpful to you.

Yours truly,

www.globalphilanthropy.ca

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