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SECTION 149(1)(l)

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PRINCIPAL ISSUES: Whether the NPO meets the requirements of 149(1)(l).

POSITION: Likely no

REASONS: Fact specific

November 21, 2012

Small & Medium Enterprises Directorate HEADQUARTERS

112 Kent Street, 19th Floor Income Tax Rulings

Ottawa, ON K1A 0L5 Directorate

Ann Townsend

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2012-045550

Attention: Rubin Dressler

Non Profit Organization (“NPO”) Project - XXXXXXXXXX (the “Corporation”)

This is in response to your correspondence of July 10, 2012, asking for our comments with respect to the tax-exempt status of the Corporation pursuant to paragraph 149(1)(l) of the Income Tax Act (the “Act”) for the XXXXXXXXX and XXXXXXXXX taxation years.

FACTS

Based on the information you have provided to us, our understanding of the facts are as follows:

- * The Corporation was incorporated on XXXXXXXXXX without share capital in the Province of XXXXXXXXXX. Its mandate is to XXXXXXXXXX.
- * The only member of the Corporation is XXXXXXXXXX (the “Parent”).
- * The Parent is also a non-share corporation incorporated in the Province of XXXXXXXXXX and files its tax returns as a NPO. The mandate for the Parent is to XXXXXXXXXX, which it achieves through the receipt of government grants and the operation of XXXXXXXXXX. The cost of a lifetime membership in the Parent is \$XXXXXXX and members must XXXXXXXXXX.
- * When the Corporation was first established it provided loans XXXXXXXXXX, the Corporation found it had accumulated funds and XXXXXXXXXX investing in XXXXXXXXXX. The Corporation’s reported retained earnings for the year ending XXXXXXXXXX was approximately \$XXXXXXX.
- * During the years under audit, the primary activity of the Corporation was the XXXXXXXXXX. It generated income from the XXXXXXXXXX and earned interest income from bank accounts.
- * The Corporation is charged a management fee of \$XXXXXXX in each year by the Parent. There is evidence to support that the management fee paid to the Parent is unreasonable in comparison to any actual work done. Without the management fee, the Corporation would show a profit in the years under audit.
- * In XXXXXXXXXX the Corporation disposed of XXXXXXXXXX and reported a capital gain of

\$XXXXXXXXXX on its financial statements. The Corporation purchased XXXXXXXXXXXX in the XXXXXXXXXXXX year for almost \$XXXXXXXXXX.

* The Corporation owns XXXXXXXXXXXX% of the Class A common shares of XXXXXXXXXXXX (the “Subco”). The remaining shares are owned by a corporation that is not an NPO.

OUR COMMENTS

In general terms, paragraph 149(1)(l) of the Act, provides that the taxable income, including taxable capital gains, of a corporation is exempt from tax under Part I for a period throughout which a corporation meets all of the following requirements:

- * 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
- * it does not distribute or otherwise make available for the personal benefit of a member or shareholder any of its income, unless the organization is an association which has as its primary purpose and function the promotion of amateur athletics in Canada.

An organization claiming a paragraph 149(1)(l) tax exemption can earn a profit, as long as the profit is incidental and arises from activities directly connected to its not-for-profit objectives. It is always a question of fact whether carrying on a business will result in an entity having a profit purpose. Paragraph 7 of Interpretation Bulletin IT-496R “Non-Profit Organizations” provides a list of characteristics that the CRA will consider in making this determination. The Tax Court of Canada agreed in BBM Canada vs MNR, 2008 DTC 4129 (T.C.C), that these were reasonable considerations for the purposes of applying the tax exemption. The characteristics considered include whether:

- * there is a trade or business in the ordinary sense,
- * goods or services are not restricted to members and their guests,
- * the business is operated on a profit basis rather than a cost-recovery basis, and
- * the business is operated in competition with taxable entities carrying on the same trade or business.

As noted above, having profits will not preclude an entity from claiming the tax exemption provided by paragraph 149(1)(l) of the Act, as long as the profits are incidental and arise from activities that are undertaken to meet the organization's 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. For example, 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 profits arising from these reserves or accounts will not affect the tax-exempt status of an organization.

Based on the facts as provided above, including the large amount of retained earnings, it appears that the Corporation has not operated for a purpose other than profit. As noted by the Supreme Court in Woodward Pension Society, 62 DTC 1002 (S.C.C), if the objectives of the organization cannot be achieved without the making of a profit, then the organization must be organized and operated for the purpose of profit. Since membership fees were not collected from its members, the Corporation's objective and ability to expand and purchase XXXXXXXXXX is only achieved by the earning of profits.

We are also concerned that the management fees paid to the Parent were not on a cost-recovery basis. If that is the case, it appears that the Corporation may have made income available to its members by transferring amounts to its Parent in excess of costs. Neither the CRA nor the courts accept that using profits to finance not-for-profit objectives is sufficient to negate a profit purpose. If an entity 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.

In addition, the shares held by the Corporation in Subco may indicate a profit purpose. The CRA has accepted that where an organization that otherwise qualifies for the exemption under paragraph 149(1)(l) engages in income-generating activity that is carried out in a taxable, wholly-owned corporation, and this corporation pays dividend 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).

However, the above facts indicate that the Corporation had excess funds available to invest in a taxable corporation and there is no evidence to support that the use of funds in this manner supports the organization's not-for-profit objectives. As discussed in paragraph 8 of IT-496R, where assets representing accumulated excess income are used for purposes unrelated to the organization's not-for-profit objectives, such as long-term investments to produce property income, or loans to members, shareholders or non-exempt persons, profit may be considered to be one of the purposes of which the association was operated.

CONCLUSION

Therefore, based on the above analysis, we agree that the Corporation was not operated for a purpose other than profit and income has been made available to its member thus it does not meet the requirements of paragraph 149(1)(l) of the Act.

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.

R.A. Albert, CA

Manager

Non-Profit Organizations and Aboriginal Issues Section

Business and Employment Income Division

Income Tax Rulings Directorate

Legislative Policy and Regulatory Affairs Branch

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