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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: General questions about 149(1)(l)

POSITION: General positions provided.

November 27-29, 2011 CTF (Canadian Tax Foundation) Question regarding paragraph 149(1)(l)

1. At the 2010 CTF National Conference CRA Round Table, the CRA commented that the findings of the NPO Risk Identification Project would “increase the CRA’s information about the NPO sector and [...] assist in the determination of: - the level of non-compliance in the sector; - any significant data gaps that may require mandatory filing of prescribed forms; and – whether recommendations to the Department of Finance for more robust legislation are necessary”.

a) Can the CRA provide an update on the status of the NPO Risk Identification Project?

CRA's response

* The CRA, through the Non-Profit Organization Risk Identification Project (NPORIP), has identified about 39,000 entities that file T2, T3 and/or T1044 returns claiming exemption under this provision. The CRA will audit 1,440 randomly selected NPOs over three years, approximately 480 files each year.

* The Project is currently in its second year.

* The audits start as a review of the organizations' tax-exempt status, followed by a full-scope audit of the corporate file. The majority of organizations will not be re-assessed.

* Should an entity claim but not qualify for the exemption under 149(1)(l) of the Income Tax Act , the CRA will conduct a full compliance audit of the corporate file and associated amounts reported on the T1044, T2 and T3 returns.

* The results of the NPORIP will allow the CRA to determine the compliance risk in the sector and recommend courses of action if required.

* The results of the audit findings will be compiled in a report to assist with the development of a compliance strategy.

* As this is a research project, it would be premature at this time to comment on the results of the pilot and what further courses of action would be recommended.

b) Will the CRA be recommending changes to the relevant legislation?

CRA's response

If the NPO Risk Identification Project identifies particular areas of concern within the NPO sector, this information will be shared with the Department of Finance.

2. In 2009, the CRA issued a number of technical interpretations that appeared to signal a more restrictive approach to paragraph 149(1)(l) than that set out in Interpretation Bulletin IT-496R, “Non-Profit Organizations”.

Does IT-496R continue to reflect the views of the CRA?

CRA’s response

Interpretation Bulletin IT-496R, “Non-Profit Organizations”, generally continues to reflect the views of the CRA. Interpretations issued since the bulletin was written in 2001 clarify and, in limited cases, modify our comments in the bulletin.

3. The interpretation of the requirement in paragraph 149(1)(l) that an organization be “organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit” has proved particularly contentious.

In one 2011 document (2010-0380581I7), the CRA stated that “[l]imited 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” (emphasis added).

However, the CRA has also stated that, in its view, the use of the word “exclusively” in paragraph 149(1)(l) indicates that while an organization may have many purposes, none of those purposes may be to earn a profit such that, where an organization intends, at any time, to earn a profit, it will not be exempt from tax under paragraph 149(1)(l) even if it expects to use or actually uses that profit to support its not-for-profit objectives.

How should these statements be reconciled?

CRA’s response

Profits from fundraising activities described in the 2011 document are usually incidental when viewed in terms of the amounts involved and in relation to the operations of an organization as a whole. Consequently, the CRA does not view these activities as indicating a profit purpose. Earning profits that are not incidental may indicate that an organization has a profit purpose even if the profits are destined to support the not-for-profit objectives of the organization or another organization.

4. When will the CRA consider profit to be “incidental” to an organization’s exclusively not for-profit purposes? For example, assume an organization – that is not a charity – is organized exclusively for a purpose other than profit.

a) Could the organization put on an event connected to its not-for-profit activities that is intended to generate a profit?

b) Would the amount of the profit (in absolute dollars or relative to the organization’s other revenues or expenses) be relevant?

c) Would it make a difference if the profit generated by the event were used to (i) pay down long-term debt, (ii) establish a reserve for future years, or (iii) defray the organization’s general operating expenses such that, on the whole, the organization operates on a break-even basis for the year?

CRA’s Response

An organization can put on an event connected to its not-for-profit activities and earn a profit as long as the profit is incidental. Whether profit is incidental depends on the amount involved and the scope and nature of the activities compared to the operations of the organization as a whole.

The amount of the profit, both in absolute dollars and especially relative to the organization’s other revenues and expenses, is relevant.

If the profit generated by the event is incidental, it does not matter how the profit is used to meet the organization’s not-for-profit objectives, as long as the income is not payable to, or otherwise available for the benefit of members. Any reserve established for future years should be limited to identified, specific (operational or capital) needs; a reserve established for the purpose of generating investment income will likely indicate that the organization is not operating exclusively for a purpose other than profit.

5. The CRA has stated that “[m]aintaining 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” (2010-038058117).

Can the CRA provide a rule of thumb as to the quantum of accumulated income that the CRA would generally consider to be acceptable?

CRA's Response

No. As explained in Interpretation Bulletin IT-496R, “Non-Profit Organizations”, the amount of accumulated excess income considered reasonable in relation to the needs of an organization to carry on its not-for-profit activities and goals is a question of fact in each situation to be determined with regard to the organization's particular circumstances.

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