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DOCNUM 2019-0825751E5
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DESCKEY 25
RATEKEY 2
REFDATE 210226
SUBJECT Whether a NPO has a profit purpose
SECTION 149(1)(l)
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PRINCIPAL ISSUES: 1. Can a NPO add a secondary source of income? 2. Can an NPO fund a secondary business from a reserve accumulated from excess member contributions? 3. Can an NPO provide services to non-members?

POSITION: 1 No, a NPO cannot have a secondary source of income. 2 No, a NPO cannot fund a secondary business. 3. Yes.

REASONS: 1 This would indicate a profit purpose. 2. The accumulation of a reserve large enough to fund a secondary business is an indication of a profit purpose. 3. There is nothing in the legislation that would prevent a NPO from providing services to non-members, provided it does not have a profit purpose.

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2019-082575
Ann Townsend

February 26, 2021

Dear XXXXXXXXXX:

Re: Non-Profit Organization having a secondary stream of income

This is in reply to your letter, concerning an organization that claims the exemption from tax as a non-profit organization (NPO) under paragraph 149(1)(l) of the Income Tax Act (Act). The situation you have described involves an NPO that is owned by its members and does not make income available for the benefit of its members.

In this letter, unless otherwise expressly stated, all statutory references are to the provisions of the Act.

You have asked whether the NPO will cease to meet the conditions of paragraph 149(1)(l) if it:

1. Adds a secondary business not related to its non-profit objective and uses the net income from the secondary business to fund its non-profit objectives.
2. Provides services to non-members.

OUR COMMENTS

This technical interpretation provides general comments about the provisions of the Act and related legislation (where referenced). It does not confirm the income tax treatment of a particular situation involving a specific taxpayer but is intended to assist you in making that determination. The income tax treatment of particular transactions proposed by a specific taxpayer will only be confirmed by this Directorate in the context of an advance income tax ruling request submitted in the manner set out in Information Circular IC 70-6R10, Advance Income Tax Rulings and Technical Interpretation.

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

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

You have asked whether a an NPO can add a secondary business and use the net income from this business to fund its non-profit objectives. You have indicated that the funding of this secondary business will be from a reserve accumulated from excess member contributions and held for future capital expenditures.

The courts have recognized that 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. 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 profit arising from these reserves or accounts will not affect the tax-exempt status of an organization.

However, an organization will not be exempt from tax pursuant to paragraph 149(1)(l) if earning profits is a purpose of the organization, even if the profits are destined to support the not-for-profit purposes of the organization or another organization. This "destination of funds" argument has been rejected by the Canada Revenue Agency and the courts on numerous occasions for both charities and 149(1)(l) organizations. Therefore, the organization you have described will be considered to have a profit purpose if it intentionally earns profit from a secondary business and uses that profit to fund its non-profit objectives.

Additionally, as stated in paragraph 8 of Interpretation Bulletin IT-496R, an organization may earn income in excess of its expenditures provided the requirements of the Act are met. However, if a material part of the excess is accumulated each year and the balance of the accumulated excess at any time is greater than the organization's reasonable needs to carry on its non-profit activities, profit will be considered to be one of the purposes for which the association was operated. This will be particularly so where assets representing the accumulated excess are used for purposes unrelated to its objects.

It is our view that a reserve that is able to fund a secondary business suggests that the organization has retained earnings larger than is necessary to meet its not-for-profit objectives and therefore the organization may not be operating exclusively for a purpose other than profit. However, a review of all of the circumstances, including (but not limited to) how and why the surplus was accumulated and the length of time the surplus has been accumulated may indicate that the organization does not have a profit purpose, notwithstanding the surplus. In addition, generally surpluses may not be viewed as reflecting a for-profit motive if the entity is taking reasonable business steps to reduce the surpluses e.g., by adjusting the costing of its products or services.

You have also asked if a NPO can provide its services to non-members. In your situation the organization has entered into an agreement to provide the same services it provides to members, to non-members that are located outside of the geographical area where the organization currently services its members.

Paragraph 149(1)(l) does not prevent a NPO from providing services to non-members, provided it otherwise meets all of the requirements of the Act. It is a question of fact whether an organization is operating exclusively for any purpose other than profit and whether income is being made available for the personal benefit of any member or shareholder. Such a determination can only be made after the end of the period for which the exemption is claimed. However, if an organization is actively earning income from non-members and using the earned income to fund its non-profit

objectives, it will be considered to be operating with a profit purpose. In addition, paragraph 7 of Interpretation Bulletin IT-496R provides characteristics that might indicate that an activity is a trade or business, which may indicate that an association is not operated exclusively for non-profit purposes. These characteristics include where an organization's goods or services are not restricted to members and their guest or where it is operated in competition with taxable entities carrying on the same trade or business.

We trust the above comments will be of assistance.

Yours truly,

Roger Filion, CPA, CA
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