

# Non-profit groups wary of CRA stance

By DONALEE MOULTON

Signals from the Canada Revenue Agency are indicating a rocky road ahead for non-profit organizations. However, the final interpretation will likely depend on the courts.

"We're getting one set of messages from the courts, which are generally pretty favourable to the sector. At the same time, the CRA is taking a restrictive view," said Robert Hayhoe, a lawyer with Miller Thomson LLP in Toronto.

This view, while becoming more focused, is not breaking new ground for Canada's national tax agency, he added. "(The CRA's interpretations) have been internally consistent and become more restrictive."

Take, for example, the issue of not-for-profit organizations actually earning a profit. "You can't run a business on the one hand with the intention to make money to finance a non-profit," said Adam Aptowitz, a principal with Drache Aptowitz Professional Corp., a law firm based in Ottawa.

"There was a question, and a reasonable question, to say, 'do we look at the not-for-profit in aggregate or does each activity have to be run without a view to profit,'" he added. "The case law said the latter."

Now the CRA is extending this



reasoning to any surplus budgeted on any activity. In a recent document issued by the agency, it noted the *Income Tax Act* requires that a non-profit organization operate "exclusively" for "any other purpose except profit" in order to be exempt from tax.

"In our view, the use of the word 'exclusively' indicates that while an organization may have many purposes, none of those purposes may be to earn a profit.

Thus, where an organization intends, at any time, to earn a profit, it will not be exempt from tax... even if it expects to use or actually uses that profit to support its not-for-profit objectives," Eliza Erskine, manager of non-profit organizations with the CRA regulatory affairs branch in Ottawa, stated in the document.

There was some leeway, she noted. "Earning a profit, in and of itself, does not prevent an organization from being a (non-profit) entity. However, the profit should generally be unanticipated and incidental to the purpose or purposes of the organization."

The implications of this interpretation are seen as significant. "It means any activity you budget to make money on is suspect," said Hayhoe, who is the national chair of Miller Thomson's charities and not-for-profit group.

"It's OK to make a surplus by accident," he added. However, "if you budget a surplus the CRA's view is you are no longer a non-profit."

This seems to fly in the face of what the courts in Canada have concluded. "To build up reasonable reserves is not a for-profit initiative. It is what is often required to run an organization. The case law has fairly consistently supported this," said Terrence S. Carter, managing partner with the law firm Carters Professional Corporation in Orangeville, Ont.

"The CRA has recently taken a narrower interpretation," he noted. "We don't know yet if this is the law. It will have to be tested in the courts."

"The law says it is a matter of intent," said Hayhoe.

The CRA says it is a matter of interpretation — and acknowledges its interpretation may prevent a legally organized and established non-profit organization from enjoying the benefits of that status. "In our view, any profit purpose prevents an organization from being a (non-profit) entity. Consequently, it is possible for an

organization to meet the requirements of federal or provincial 'not-for-profit' incorporation legislation, but not qualify for the tax exemption provided under... the act," Erskine noted in the CRA's response document.

The conflict between case law and the CRA is causing confusion among non-profits. Experts like Hayhoe are getting calls from organizations looking for guidance on what to do in the wake of recent

to the attention of the CRA. "Beware of novelty and innovation," he noted. "You can't operate some businesses at a profit to subsidize the organization as a whole. (If you do), you are not immune to the CRA taking a look."

What non-profits should not do is overreact, said Carter. "I'm advising clients not to change their modus operandi at the present time. This is only a heads-up at this point. For now, it's still business as usual in accordance with the existing case law.

"The issue is profit," he added. "If one isolated area of what a non-profit does is a profit centre, it does not necessarily turn an organization into a profit-making entity."

Non-profit organizations have historically not been at the top of the tax agency's priority list. "Until recently, it was a stumbling-across situation with the CRA," said Hayhoe. "But there are rumblings that an audit program may be launched.

"There seems to be a concern from the CRA's point of view that there is a lot of money being made by non-profits. Many are seen to compete with competitive businesses," he added.

While "there is no history of the CRA going after not-for-profits," noted Aptowitz, "it would not be imprudent for the CRA to do this."

One reason for the newfound interest may lie with the general obscurity in which many non-profits live out their existence. "There are about the same number of registered charities in Canada as there are non-profits — about 85,000 in each group — but charities have generally experienced more audits," noted Carter. "There is very little by way of regulation of non-profits. There is not much to work with."

Trying to understand the lay of the land and the Canada Revenue Agency's role in helping to shape the landscape is not easy. The agency, noted Carter, does not make the law. "Technical interpretations from the CRA are not binding, and they are also limited to the facts in question."

However, he added, recent CRA actions "may indicate a pattern."

Whether that pattern is legally enforceable remains to be evaluated — by the courts. The CRA's track record on this front is not strong.

"Over the years, there have been several cases where the CRA has attempted to go after non-profits," noted Aptowitz. "They have lost every case."

Should they emerge victorious from what appears to be the battle that is brewing, the results could spell a death knell for many non-profits. "If the CRA is going to use this narrow interpretation, there would seem to be little reason to have non-profits," said Carter. "It would render them impractical."



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interpretations, including Erskine's document. His advice: remind the CRA why you are the type of organization you are. "It's important that non-profits in doing their planning prepare documents that stress the mission and purpose of activities — not the revenue," stressed Hayhoe.

He also has some advice for accountants. "Financial people need to make sure reserves are booked and have a flat result for the year."

Aptowitz also highlighted the need to ensure a T2 return is filed or an information return submitted for those non-profit organizations that meet the required threshold for reporting to the CRA.

As well, he pointed out that standing out from the crowd makes a non-profit more visible, and perhaps more likely to come

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