
NEW CRA POLICY ON CHARITIES AND BUSINESS ACTIVITIES

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A. INTRODUCTION

This *Charity Law Bulletin* (“*Bulletin*”) provides a brief overview of the Canada Revenue Agency (“CRA”) *Policy Statement* entitled *What is a Related Business?* that was released by on March 31, 2003 (“*Policy Statement*”). The *Policy Statement* is applicable to charities that are currently or plan in the future to be involved in business activities in conjunction with their charitable endeavours. The *Policy Statement* can be accessed at the CRA website at <http://www.ccra-adrc.gc.ca/tax/charities/policy/cps/cps-019-e.html>.

Portions of this *Bulletin* were previously published in a paper prepared for the Sixth Annual Estates and Trusts Forum entitled, “Recent Changes under the *Income Tax Act* and Policies Related to Charities and Charitable Gifts,” on November 19, 2003, which can be accessed at <http://www.carters.ca/pub/article/charity/2003/tsc1119.pdf>.

B. DEFINITION OF RELATED AND UNRELATED BUSINESS

According to the *Policy Statement*, “business” in the context of a charity means an activity that is commercial in nature, from which the charity derives revenue from providing goods or services, and which are undertaken with the intention to earn profit. It indicates that “a charity can engage in some business-like transactions, provided they are not operated regularly or continuously.” Other than businesses run by volunteers, as provided under subsection 149.1(1) of the *Income Tax Act* (“*ITA*”) that are deemed to be related businesses,

CRA takes the position that permitted related businesses are only those that are “linked to a charity’s purpose” and are “subordinate to that purpose.”

Accordingly, the two kinds of related businesses are as follows:

- ◆ businesses that are linked to a charity's purpose and subordinate to that purpose, such as:
 - a hospital's parking lots, cafeterias, and gift shops for the use of patients, visitors, and staff;
 - gift shops and food outlets in art galleries or museums for the use of visitors;
 - book stores, student residences, and dining halls at universities for the use of students and faculty; and
- ◆ businesses that are run substantially by volunteers, which is a deemed related business under the *ITA*. If 90% of the people involved in operating the business are unpaid volunteers, e.g. a hospital auxiliary’s gift store, the business activity will be deemed a related business. This type of related business does not have to be linked to the charity’s charitable purposes.

An unrelated business is a business activity that is neither related nor deemed related, e.g. a youth centre running an operation to buy and sell used computers for profit, or running a catering business with paid employees. Charities cannot participate in unrelated businesses, as they risk losing charitable registration. The *ITA*, section 149.1(2) provides that the Minister of National Revenue may revoke the registration of a charitable organization if it “carries on a business that is not a related business of that charity.” However, the *ITA* provides that a charitable organization shall be considered to be “devoting its resources to charitable activities carried on by it to the extent that it carries on a related business” as defined under the *ITA*, section 149.1(6).

C. CRA CRITERIA IN DETERMINING A BUSINESS

As indicated above, a business is generally defined as a commercial activity undertaken with the intention to earn profit. The *Policy Statement* lists the following criteria as having been established by the courts to determine whether or not an activity is a business on a case-by-case factual analysis:

- *The intended course of action* - If the rationale for operating a given activity is to generate a profit, then the activity is likely a business.

- *The potential to show a profit* - Even if an activity does not yield a profit, it may nonetheless be capable of earning a profit. In determining whether a particular activity is a business, it is the intention and capacity to make a profit at some point that are relevant. On the other hand, if the activity is structured so that it is incapable of returning a profit, then it is not a business.
- *The existence of profits in past years* - When the activity has been carried on for some time, a history of it returning a profit would generally imply that a business exists.
- *The expertise and experience of the person or organization that undertakes the activity* - If the person or organization that is undertaking the activity has been selected for the position because of his/her/its commercial knowledge, skill, or experience, it may indicate that the activity is commercial in nature and so may be a business.

D. CRA CRITERIA IN DETERMINING A RELATED BUSINESS

CRA will determine that a business is “linked” to a charity’s purpose if one of the following criteria is satisfied:

- ◆ “A usual and necessary concomitant of charitable programs” - These are business activities that supplement a charity’s charitable programs, either because they are “necessary for the effective operation of the programs,” or they “improve the quality of the service delivered in these programs.” For example, a hospital’s parking lots, cafeterias, and gift shops for the use of its patients, visitors and staff, as well as university book stores or student residences;
- ◆ “An off-shoot of a charitable program” – In the ordinary operation of a charity’s charitable program, a charity may create an asset that it can exploit in a business, i.e. “the asset is simply a by-product of the charity’s programs.” For example, a church sells recordings of its special Christmas services hosted by its famous choir at as high a price as it can obtain;
- ◆ “A use of excess capacity” – This type of business involves “using a charity’s assets and staff, which are currently needed to conduct a charitable program, to gain income during periods when they are not being used to their full capacity within the charitable programs.” For example, a university renting out its residence facilities in the summer months when they are not required for use by the students or a church renting out used parking spaces during the week when it is not being used by the church;
- ◆ “The sale of items that promote the charity or its objects” – This type of business activity involves “sales that are intended to advertise, promote, or symbolize the charity or its objects.” Examples would include the sale of pens, credit cards, and cookies that clearly display the charity’s name or logo, and T-shirts or posters depicting the work of the charity.

When determining whether a business is “subordinate” to a charity’s purpose, it is important that the business “remains subservient to a dominant charitable purpose, as opposed to becoming a non-charitable purpose in its own right.” There are four factors that are considered by CRA in this regard:

- (i) Relative to the charity’s operations as a whole, the business activity receives a minor portion of the charity’s attention and resources.
- (ii) The business is integrated into the charity’s operations, rather than acting as a self-contained unit.
- (iii) The organization’s charitable goals continue to dominate its decision-making.
- (iv) The organization continues to operate for an exclusively charitable purpose by, among other things, permitting no element of private benefit to enter in its operations.

In determining whether the related business activity is subordinate to the charitable purposes, the *Policy Statement* states that the charity must review whether the activity is a minor portion of the charitable purposes, whether the charitable purposes are the main focus of its activities and whether there is any private benefit from the related business activity. The related business is subordinate to the charity's purposes if it receives a minor portion of the charity's attention; it is integrated into the charity's operations; its charitable goals continue to dominate decision-making affecting it; and private benefit does not become one of its elements.

E. IMPLICATIONS FROM *EARTH FUND* DECISION

In addition to the *Policy Statement* on related business, charities considering the operation of a related business should be aware of the *Earth Fund v. Canada (Minister of National Revenue – M.N.R.)*, [2002] D.T.C. 5016 (F.C.A.) (“*Earth Fund*”) decision, which is currently the leading Canadian decision with respect to charities and related business. In *Registered Charities Newsletter* No. 15, issued April 9, 2003, CRA drew attention to the decision by reporting as follows:

On December 16, 2002, the Federal Court of Appeal unanimously dismissed the appeal of Earth Fund/Fond Pour la Terre (“Earth Fund”) from our decision to refuse to register it as a charity.

In *Earth Fund*, the applicant Earth Fund applied for charitable registration with the intent to “promote the preservation and enhancement of the environment for human life and well-being on Earth; promote,

encourage, and support programs and activities for the creation of greater public awareness of environmental issues and to mobilize the resources of private citizens and organizations to contribute to the resolution of such issues,” among other corporate objects. Earth Fund planned to fund its charitable activities via an on-going or other lottery that would directly or indirectly fund its projects, which included the following:

Projects relating to the objects of the Corporation and the global environment, ecology and humanitarian activities relating to health, habitat, migration of refugees or other population groups, natural or non-natural catastrophes, health and welfare of children and environmentally sustainable development, on its own behalf or through its charitable agents. (para 3)

CRA refused to register Earth Fund as a charitable foundation based on the fact that the Minister held that Earth Fund was not created for exclusively charitable purposes. The Minister also refused to register Earth Fund on the grounds that Earth Fund was not entitled to carry on a lottery business while registered as a charitable foundation. In the Federal Court of Appeal, Justice Sharlow agreed with CRA, and upheld the refusal to register Earth Fund.

Firstly, Justice Sharlow noted that Earth Fund took the position that since the proposed lottery related to only some of its corporate objects; the other objects could be dismissed. However, Justice Sharlow rejected this argument by stating that

[The] appellant's argument rests on an invalid premise. As a matter of law, the appellant is not entitled to registration as a charity unless all of the appellant's corporate objects and activities are exclusively charitable. That is clear from the definition of 'charitable foundation' from subsection 149.1(1), quoted above, which requires a charitable foundation to be 'constituted and operated exclusively for charitable purposes. (para 20)

Secondly, Justice Sharlow found that Earth Fund had argued that since the *ITA* did not limit charitable foundations in their fundraising efforts, proceeds from the lottery could go to qualified donees. Earth Fund relied on the *Alberta Institute on Mental Retardation v. Canada* [1987] 3 F.C. 286, (1987) 76 N.R. 366, [1987] 2 C.T.C. 70, (1987) 87 DTC 5306 (F.C.A.), leave to appeal dismissed, [1988] S.C.C.A. No. 32 (“*Alberta Institute*”) case in this position, as the Alberta Institute raised funds in conjunction with Value Village, and was in the end, registered by CRA. Justice Sharlow also rejected this argument by stating that:

I do not accept the argument of counsel for the appellant that the *Alberta Institute* case is authority for the proposition that any business is a 'related business' of a charitable foundation if all of the profits of the business are dedicated to the foundation's charitable objects. The Minister in that case was arguing that Alberta Institute was 'a wholesaler of goods', but in fact Alberta Institute was simply soliciting donations of goods which it converted to money. (para 30)

... [The] appellant proposes to do nothing except market and sell lottery tickets in a manifestly commercial arrangement that will, if all goes as planned, result in a profit that will be donated, I assume, to qualified donees. The appellant is in exactly the same position as any commercial enterprise that commits itself to apply its profits to charitable causes. Such a commitment, by itself, does not derogate from the commercial nature of the activity that generates the profit. Given the particular facts of this case, the Minister was justified in concluding that the appellant's proposed lottery operation would be a business of the appellant that is not a 'related business', and thus would not qualify as a charitable activity. (para 30).

The *Earth Fund* decision provides a clear statement that the *Alberta Institute* case is not authority for the "destination test," i.e. the argument that as long as the intended beneficiary is a charitable purpose, then any business carried on by the charity would be deemed to be a related business.

F. CONCLUSIONS

The *What is a Related Business? Policy Statement* is of critical importance to charities that are involved or considering becoming involved in business activities of any type. If an organization that is operating an unrelated business applies for charitable status, its application will be denied by CRA. A registered charity that becomes involved in operating an unrelated business will be in breach of the *ITA*, and could lose its charitable registration. By carefully ensuring that a charity is only involved in an acceptable related business activity as outlined by CRA in the *Policy Statement*, a charity will avoid unnecessary prejudice to its charitable status.