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CHARITIES AND THE GST/HST

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A. INTRODUCTION

Section 165 of the *Excise Tax Act*, R.S.C. 1985, c. E-15, provides that every recipient of a taxable supply in Canada shall pay tax to the federal government in respect of the supply, calculated at a rate of 7 percent on the total value of the consideration for the supply. This is referred to as the Goods and Services Tax ("GST"). Three Atlantic provinces – Nova Scotia, New Brunswick and Newfoundland and Labrador – pay an amount equivalent to the provincial sales tax in addition to the GST on the value of the consideration for the supply. This is referred to collectively as the Harmonized Sales Tax ("HST") and is calculated at a rate of 15 percent. Everyone in Canada, with the exception of provincial and territorial governments, Indians, and Indian bands, must pay the GST/HST on taxable supplies of goods and services made by a GST/HST registrant. Generally, organizations involved in commercial activities in Canada are obliged to register for GST/HST because most of their supplies are taxable and they do not qualify as small suppliers. Registered organizations must collect and remit the tax, although they can claim input tax credits ("ITC") to recover the tax paid or owed on purchases and operating expenses used, consumed, or supplied in their commercial activities. Charities are an exception to this general rule, with exemptions on most of their supply of goods and services. Charities do not fit into the general mould for GST/HST.

As of January 2004, the Charities Directorate of the Canada Revenue Agency ("CRA") calculated the charitable sector in Canada to have grown to over 80,500 organizations. This *Charity Law Bulletin* focuses on charities and the GST/HST. CRA's publication entitled "GST/HST Information for Charities" can be found at http://www.cra-arc.gc.ca/E/pub/gp/rc4082/rc4082-02e.pdf. As different rules apply, non-profit organizations should refer to the CRA publication, entitled "GST/HST Information for Non-Profit Organizations," available at http://www.cra-arc.gc.ca/E/pub/gp/rc4081/rc4081-e.pdf.

In order for a charity to determine its rights and obligations under the GST/HST, the charity must first determine the nature and scope of its activities. Charities fall into three categories:

a) When all goods and services supplied are exempt goods and services;
b) When some goods and services are taxable, but the charity qualifies as a small supplier; or
c) When some goods and services are taxable and the charity does not qualify as a small supplier.

B. CHARITIES WITH EXEMPT GOODS AND SERVICES

As a general rule, most supplies made by charities are exempt. The CRA does not have a definitive list of exempt goods and services, but does provide guidance through its publication entitled "*GST/HST Information for Charities*." Examples of exempt goods and services that are exempt when rendered by charities provide them include:

- Most services provided by a charity;
- Supplies of used and donated goods;
- Short-term residential accommodation (less than one month of occupancy);
- Meals-on-wheels programs;
- Parking space rentals;
- Facility rentals;
- Catering services for private functions;
- Fund-raising activities that are not provided on a regular or continual basis;
- Goods and services supplied for an amount that does not exceed the direct cost;
- Certain gambling events;
- Recreational programs provided primarily for children 14 years of age or younger;

- Where substantially all (i.e. 90 percent or more) supplies are made free of charge, then all supplies of that good or service are exempt;
- Memberships supplied without significant benefit;
- Admissions to places of amusement if the maximum admission charged is $1 or less, or where charitable receipts for income tax purposes may be issued, or where admission is supplied to an athletic event at which 90 percent or more of the athletes or competitors are not paid; and
- Supplies made for the relief of poverty, suffering or distress of individuals.

If a charity's activities fall within these categories of exempt goods and services, then specific rules apply. First, the charity cannot register for GST/HST. Second, the charity cannot charge tax on its supplies. Third, the charity cannot claim ITCs to recover the GST/HST paid or owing on its purchases. Finally, the charity would be eligible to claim a public service bodies' ("PSB") rebate of 50 percent of the GST/HST paid or owing on eligible purchases or expenses.

C. CHARITIES WITH TAXABLE GOODS AND SERVICES

The supply of goods and services that fall outside of the above-listed exemptions may mean the charity is providing taxable goods and services. As such, the charity must determine if the scope of its activities requires it to register for GST/HST and charge and remit tax on its supply of goods and services. CRA regulations require that a charity must register for GST/HST if two conditions are met:

a) The charity provides taxable goods and services in Canada, and
b) The charity does not qualify as a small supplier.

Two tests are available to determine if a charity qualifies as a small supplier. A charity need only meet one of the two following tests to qualify as a small supplier, i.e. either:

a) the Gross Revenue Test, and
b) the $50,000 Annual Taxable Supplies Test.

2. Gross Revenue Test

The annual limit for the gross revenue test for a charity is $250,000. Basically, a charity will qualify as a small supplier if gross revenues for the fiscal year amount to $250,000 or less. If the charity is in its first fiscal year, it need not register for GST/HST, regardless of gross revenue. In the charity's second fiscal year, gross revenue is calculated from the first fiscal year to make the determination as to small supplier status. In subsequent years, the charity will calculate the gross revenue in each of the two previous fiscal years. If the total amount is $250,000 or less in either year, the charity will continue to qualify as a small supplier.

Gross revenue includes business income, donations, grants, gifts, property income, and investment income, less any amount considered a capital loss for income tax purposes. In making the calculations, the charity must include revenues from the organization as a whole, meaning income generated from branches or divisions must be included.

3. $50,000 Annual Taxable Supplies Test

The annual taxable supplies limit is $50,000 for charities and other PSBs. The charity must calculate its total revenue from taxable supplies in the current calendar quarter, and the total revenue from taxable supplies in the last four calendar quarters. If both amounts are $50,000 or less, then the charity qualifies as a small supplier. If the amounts are more than $50,000, the charity must register for GST/HST and charge and remit the tax, unless the charity qualifies as a small supplier under the gross revenue test.

Charities that qualify as a small supplier have certain rights and obligations. First, like the charity supplying exempt goods and services, small supplier charities cannot charge tax on their supplies. Similarly, they cannot claim ITCs to recover the GST/HST paid or owing on their purchases, though they are permitted to claim a PSB rebate of 50 percent of the GST/HST paid or owing on eligible purchases and expenses. Finally, charities do not have to register for GST/HST until they exceed the small supplier threshold, but they may register voluntarily.

D. CHARITIES THAT DO NOT QUALIFY AS SMALL SUPPLIERS

Charities that do not qualify as small suppliers and provide taxable goods and services in Canada must register for GST/HST. Once registered, they must collect and remit GST/HST on taxable supplies of goods and services. They must file annual returns, or they may elect to change their reporting periods, and file monthly or quarterly returns. Charities should note that failure to remit tax can result in the directors, officers or members being held liable to remit an amount of the tax owing.

Unlike those charities that have not or cannot register for GST/HST, registered charities that are registered for GST/HST can claim ITCs to recover the GST/HST paid or owing on purchases to provide taxable goods and services. ITCs can be claimed when charities file a return, or they may hold the credit over. A credit must be claimed within four years.

GST/HST registrants may also claim a PSB rebate of 50 percent of the GST (or the federal part of the HST) paid or owing on eligible purchases and expenses for which they could not claim an ITC. Most charities would also be eligible for a 50 percent rebate of the provincial part of the HST if they are residents of a participating province. Similar to the ITC credit, the PSB rebate application must be filed within four years from the due date of the GST/HST return for the claim period in which the expense was incurred.

E. VOLUNTARY REGISTRATION

If charities do not provide any taxable goods or services, they cannot register for GST/HST or charge tax on supply of goods and services. Those charitable organizations that do provide taxable goods or services, yet do not meet the threshold demanding registration, may voluntarily register for GST/HST. If they decide to register, they must begin collecting GST/HST on their taxable supply of goods and services and file GST/HST returns to account for the tax collected. By registering, charities may become eligible to claim ITCs to recover GST/HST paid or owing on expenses incurred to provide taxable goods and services. It would also be required to follow the PSB rebate rules pertaining to GST/HST registrants.

F. BRANCHES AND DIVISIONS

Whether a charity is required to register or voluntarily registers for GST/HST, it must do so as a single entity. Thus, branches or divisions of that charity cannot register separately. Similarly, when performing the calculations to determine small supplier status, the charity must include the revenue from all branches or divisions. However, the charity may apply to have each branch or division with $50,000 or less in annual taxable supplies designated as a small supplier division. If the application is approved by the CRA, the branch or division will no longer collect GST/HST on its taxable supplies and it will not claim ITCs for its purchases. To qualify, the branch or division must be separately identified by either its location or the nature of its activities; must keep separate records, books of account, and accounting systems; and must meet the $50,000 annual taxable supplies test. There is the additional qualification that the charity must not have revoked an earlier designation of the branch or division within the previous 365-day period.

Charities should note that supplies transferred between branches or divisions that are part of one entity are not subject to GST/HST.

G. SPECIAL TAXING CONSIDERATIONS

1. Donations and Gifts

   As a donation or gift is a voluntary transfer of money or property for which the donor receives no benefit in return, the GST/HST does not apply. This remains true even if the donor receives property in return that has a nominal value. However, if the donor receives a good or service having more than nominal value in exchange for the donation, the donation may be subject to tax.

2. Grants and Subsidies

   Grants and subsidies are generally viewed as transfer payments made in the public interest, and thus the CRA does not regard them as payment for supply necessitating the charging of GST/HST. However, if there is a direct link between the grant or subsidy and the supply that the charity provides to either the grantor of the transfer payment or a third party, the transfer payment may be regarded as a payment for supply and subject to taxation.[1] The CRA notes that as the tax treatment of transfer payments may be complex, they will need to be determined on a case-by-case basis.

3. Sponsorships

Depending on the nature and the extent of the promotional benefits given to the sponsor, sponsorships may not be subject to GST/HST. If the payment made by the sponsor is made primarily in order to obtain advertising, the CRA may consider it a payment for advertising services and not a sponsorship, and thus subject to GST/HST (except when a charity provides the advertising services).

H. PUBLIC SERVICE BODIES' REBATE

The PSB rebate allows certain public service bodies, including charities, to recover a percentage of the GST/HST paid on purchases and expenses. Charities are eligible for a rebate of 50 percent of the GST (or the federal part of the HST) paid or owing on eligible purchases and expenses. Most charities will also be eligible for a 50 percent rebate of the provincial portion of the HST, if they are residents of a participating province. Charities have four years from the end of the claim period to file the rebate application. Although original invoices or receipts do not have to be included in the rebate applications, for audit purposes, the charity must keep those documents for six years after the calendar year to which they relate.

Should the CRA designate a charity to be a municipality in relation to certain municipal services it provides, the charity may be able to recover 57.14 percent of the GST (or 57.14 percent of the federal portion of the HST) paid or owing on purchases and expenses related to that designated activity. GST paid or owing on purchases and expenses related to other activities will be subject to the regular 50 percent rebate.

[1] Such was the case in *Meadow Lake Swimming Pool Committee Inc. v. Canada*, [1999] T.C.J. No. 723 (T.C.C.), wherein the court upheld the assessment which found a direct link between the payment received by the non-profit organization running the municipal pool and the supply of services to the municipality. Thus, the subsidies given by the municipality to the non-profit organization to off-set the annual operating deficit were deemed to be consideration for the supply of services and subject to taxation.

1. Eligible Purchases and Expenses

Similar to the exempt goods and services, the CRA does not have a definitive list of eligible purchases and expenses for the GST/HST PSB rebate. However, some guidance has been provided. Charities can claim a rebate of 50 percent of the GST/HST paid or owing on eligible expenses, including:

- General operating and overhead expenses, such as rent, utilities, and administration expenses;
- Most allowances and reimbursements paid to employees and volunteers engaged in activities for the charity;
- Supplies bought to produce finished goods to sell, and merchandise bought to sell at fund-raising events; and
- Capital property (i.e., buildings, equipment, vehicles, machinery, office furniture, computers, and photocopiers the charity uses to carry on its activities).

2. Ineligible Purchases and Expenses

Purchases that are not eligible for the GST/HST rebate include:

- Memberships in dining, recreational, or sporting clubs;
- Goods and services bought to provide long-term residential accommodation, unless at least 10 percent of the accommodation is provided to seniors, youths, students, the underprivileged, or individuals with a disability or who are in distress;
- A good or a service acquired to sell to an officer, employee, or member of the charity, or to another person related to that person, for personal use, unless:
  - The good or service is supplied in the same year it was acquired and the charity charges an amount equal to its fair market value; or
  - If the charity were to provide the good or service free of charge to the person, it would not be a taxable benefit; and
- A good or service supplied to another person, if the good or service is a taxable benefit to that person for income tax purposes, but the charity does not have to remit any GST/HST on the supply.

Persons who operate charities out of their home, or charities that share accommodation with other entities should be cognizant of the fact that they must determine the percentage of utility bills and other shared expenses that go towards the charity's operations. The charity may only claim the rebate for the part related to the charity's operations.

I. OTHER REBATES

1. Exported Goods and Services

Charities can apply for a 100 percent rebate of the GST/HST paid to suppliers on goods and services that have been exported outside Canada and for which the charity cannot claim ITCs. The charity need not be registered for GST/HST in order to receive this rebate. This rebate does not apply to goods and services that are not exported, even if they are used in activities that support other activities outside of Canada.

2. Purchases of Printed Books

A 100 percent GST/HST rebate is also available to charities that operate a public lending library. This rebate relates to GST/HST paid or owing on publications purchased for the lending library that are not resold or given away.

J. INPUT TAX CREDITS ("ITC")

As noted above, an input tax credit is a claim to recover the GST/HST paid or owing to suppliers for goods and services acquired, imported, or brought into a participating province to provide taxable goods and services by GST/HST registrants. Simply put, ITCs are only available to the extent that purchases and expenses are for consumption, use, or supply in the charity's commercial activities. ITCs are claimed on the registered charity's GST/HST return. There are two methods by which to calculate ITCs: the general rules or the simplified method.

1. General Rules for Calculating ITCs

The general rules for calculating ITCs involve inserting a column for GST/HST paid or owing to the purchases and expenses side of the organization's records. This column is then totalled to calculate the ITCs for each reporting period.

2. Simplified Method of Calculating ITCs

The simplified method of calculating ITCs involves totalling the amount of taxable purchases for which the charity can claim an ITC. This total will include all taxes paid on the purchases. This total is multiplied by 7 and the result is divided by 107 for the GST, or for those purchases subject to HST the total is multiplied by 15 and the result is then divided by 115.

The CRA limits the use of the simplified method of calculating ITCs to organizations that have annual worldwide revenues from taxable goods and services of $500,000 or less in the last fiscal year. The total taxable supplies for the preceding fiscal quarters in the current fiscal year must also be $500,000 or less. These limits do not include goodwill, zero-rated financial services, or sales of capital real property. Once an organization begins to use this method of calculation, it must continue doing so for at least one year, as long as the organization continues to qualify.

3. Zero-rated Goods and Services

Zero-rated supplies refer to a limited number of goods and services that are taxable at the rate of 0 percent. Consequently, no GST/HST is charged on the supply of these goods and services, but they are treated in the same way as items taxable at 7 or 15 percent for the purpose of claiming ITCs. Zero-rated supplies include basic groceries, certain goods when they are exported outside of Canada, prescription drugs, certain medical devices, and services of installing, maintaining, restoring, repairing or modifying certain medical devices.

4. Real Property and ITCs

ITCs are available for the acquisition of real property by a charity to be used as capital property, subject to the primary use rule. Under this rule, a charity may claim a 100 percent ITC on the acquisition of capital property, or an improvement to capital property, if the charity intends to use the property primarily in its commercial activities. If the primary use is not for commercial purposes, the ITC cannot be claimed, but the 50% PSB rebate for the GST/HST paid or owing can be claimed. Should a charity change the primary use of a capital property there would be tax implications.

If the capital property is changed from exempt to commercial use, the CRA will deem the capital property to have been sold and reacquired at the time and to have paid GST/HST equal to the basic tax content of the property at the time. If this is done, an ITC could then be claimed.

If the capital property is changed from commercial to exempt use, the CRA deems the charity to have sold the property at that time and to have collected GST/HST equal to the basic tax content of the capital property at that time. GST/HST would then have to be remitted, essentially paying back the ITC that had previously been claimed when the property was initially purchased or improved.

5. <u>Taxable Sales and Leases of Real Property</u>

Generally, most sales, leases, or other supplies of real property by charities are exempt from GST/HST. However, there are exclusions from this general exemption to which the GST/HST would be taxable. These exclusions include the sale of a new or substantially renovated residential complex; most deemed supplies of real property; and, real property that the charity has chosen to treat as taxable by filing an election with the CRA. Should a charity elect to treat certain exempt sales and leases of real property as taxable supplies, the charity would be able to claim ITCs for the GST/HST paid or owing on the acquisition of the property, or any improvements to it to the extent that the property is used to make taxable supplies. The election would require the charity to charge GST/HST on the sale, lease, or licence of the property, the primary use rule would not apply, and the charity would calculate and claim the ITC based on the percentage of the property's use in the commercial activities. After the election has been made, the charity can claim ITCs on purchases and expenses related to the real property if they have made the election not to use the net tax calculation method assigned to charities.

K. DETERMINING NET TAX

A GST/HST registrant is required to file a GST/HST return, calculating the charity's net GST/HST remittance or refund. This calculation takes into account two things: the next tax and any instalments, rebates and other credits, and debts. Using this calculation, the charity would remit 60 percent of the GST/HST collected on most taxable supplies (100 percent GST/HST collected is remitted on some items like the taxable sales of capital and real property), less ITCs claimed on certain eligible items. The result is the net tax. Taxes paid or owing on items purchased that are not subject to the ITC may be subject to the 50 percent PSB rebate.

L. CONCLUSION

The GST/HST regulations present a minefield that charities and their boards of directors must navigate. The complexity of the regime necessitates that charities examine the nature and scope of their activities in order to properly determine their rights and obligations under the GST/HST. As the CRA does not claim to produce a definitive list of exempt and taxable activities, it is that advisable charities seek confirmation in order to make the proper determination in order to avoid unexpected liability exposure.

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