

Income Tax

IMP. 996-2 **Non-profit Organizations**
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Reference(s): *Taxation Act* (R.S.Q., c. I-3), sections 980, 985.1, 986, 996 and 997

This bulletin deals with certain criteria which may be used to determine if a club, a partnership or an association (the “organization”) fulfils the conditions required in a particular taxation year to be exempted from tax under section 996 of the *Taxation Act* (the “Act”). It should be noted that section 997 of the Act provides that certain organizations covered by section 996 of the Act must pay tax on the taxable capital gain from the disposition of certain property as well as on the income from property.

APPLICATION OF THE ACT

1. Under section 980 of the Act, no tax is payable under Part I of the Act on the taxable income of a person for a period during which he complies with the conditions required to be exempt from tax.

For its part, section 996 of the Act provides that an organization must fulfil the following conditions to be exempted from tax:

- (a) it must have been established exclusively for non-profit purposes;
- (b) it must be operated exclusively for non-profit purposes;
- (c) it is not, in the Minister’s opinion, a charity.

No part of the organization’s income is payable to any proprietor

2. Subsection 1 of section 986 of the Act provides for conditions in addition to those provided for in section 996 of the Act. Thus, an organization referred to in section 996 of the Act will not be exempted if:

- (a) part of its income is payable to any proprietor, member or shareholder thereof; or
- (b) part of its income is otherwise made available for the personal benefit of any proprietor, member or shareholder.

Certain payments made directly to proprietors, members or shareholders or indirectly for their benefit, do not, in and by themselves, disqualify an organization from the tax exemption provided in section 996 of the Act. Following are examples of such payments:

- (a) salary or wages, remuneration or fees for services performed for the organization, provided that the amounts paid are reasonable and in line with those paid in arm's length situations for similar services;
- (b) payments to employees or to proprietors, members or shareholders to assist them in covering the expenses they incur as the organization's delegates at various conventions and meetings, provided that their attendance at these conventions and meetings is to further the aims and objectives of the organization.

3. Subsection 2 of section 986 of the Act provides that for the purposes of subsection 1 of that section, the income of an organization is the amount otherwise determined less any taxable capital gain included therein. Subsection 2 only applies to allow the distribution of a taxable capital gain without prejudice to the status of the organization established under section 996 of the Act.

4. Subsection 3 of section 986 of the Act provides that subsection 1 of that section does not apply to an organization referred to in section 996 of the Act if the proprietor, member or shareholder referred to in the said subsection is an organization referred to in section 996 of the Act having as its primary purpose and primary function, the promotion of amateur athletics in Canada. Thus, without losing its right to the exemption provided for in section 996 of the Act, the organization may attribute income to a proprietor, member or shareholder that is an organization having as its primary purpose the promotion of amateur athletics in Canada.

Charities

5. If, in the opinion of the Minister, an organization is a charity, it cannot be considered as a non-profit organization exempted from tax under section 996 of the Act. Section 1 of the Act provides that in Part I of the Act and in the regulations, unless the context indicates a different meaning, the expression "charity" means a charitable organization or charitable foundation, within the meaning of section 985.1 of the Act. The charity need not be registered with the Minister or deemed to be registered in accordance with sections 985.5 to 985.5.2 of the Act to disqualify the charity from the tax exemption provided in section 996 of the Act. Furthermore, the fact that the registration of a charity is revoked under section 1063 of the Act does not render the charity eligible for the tax exemption provided in section 996 of the Act. Take note that a registered charity is exempt from tax under section 985.23 of the Act.

Corporation

6. Although not expressly stated in section 996 of the Act, a legally incorporated corporation may be exempted under that section. In addition, the fact that a corporation is incorporated without capital stock under Part III of the *Companies Act* (R.S.Q., c. C-38) is not determining per se to qualify that corporation for the exemption provided in section 996 of the Act.

Separate Entity

7. In order to determine if an organization may be exempted under section 996 of the Act, it must be considered as a separate entity from its proprietors, members or shareholders. Thus the fact

that a proprietor, member or shareholder is itself a non-profit organization referred to in section 996 of the Act does not hinder the application of the rules mentioned in sections 986 and 996 of the Act.

8. Where two separate entities are created, one exclusively for commercial purposes aimed at making profits for the other that has non-profit purposes, the first will, as a rule, not be exempted under section 996 of the Act since it is not operated exclusively for non-profit purposes.

Non-profit Purpose

9. A profit-earning purpose is a purpose aimed at realizing a gain, a benefit or a profit. Section 996 of the Act exempts from tax an organization (other than, in the Minister's opinion, a charity) that is established and operated exclusively for non-profit purposes. Since section 996 of the Act does not list any non-profit purposes in particular, here a few examples of purposes (this is not an exhaustive list) generally considered as non-profit:

- (a) social welfare, either by providing assistance for disadvantaged groups or for the common good and general welfare of the people of the community;
- (b) the enhancement in value or quality of community or civic life;
- (c) the development of recreation and the cultural life of its members;
- (d) the general enhancement of a specific sector by promoting information exchanges, knowledge of that sector, and by promoting its objectives;
- (e) the spiritual development of its members.

Organization established and operated exclusively for a non-profit purpose

10. To determine if an organization was established exclusively for a non-profit purpose, the instruments by which it was created must be consulted. These documents may include letters patent, articles of incorporation, partnership agreements, articles and so on.

11. An organization is not generally operated exclusively for a non-profit purpose if its main activity consists of carrying on a trade. This is usually the case for a trade within the usual meaning of the term; i.e. the organization mainly carries on a normal commercial activity. The following criteria may be used to determine if an activity is a trade:

- (a) the organization's goods and services are not restricted to members and their guests;
- (b) the organization is operated on a profit basis rather than a cost recovery basis; or
- (c) the organization is in competition with taxable entities carrying on the same kind of trade.

12. Other factors may be considered when determining if an organization has not been established and operated exclusively for a non-profit purpose, among them:

- (a) where the organization is a legally incorporated corporation, the fact that it has the power, at any time during its fiscal period, of declaring and paying dividends out of its income;

- (b) the fact that the organization in the event of a winding-up, dissolution or amalgamation has the power to distribute income to a proprietor, member or shareholder.

13. Situations may arise where the organization's income exceeds its expenses without the organization losing the benefit of the tax exemption provided for in section 996 of the Act. That excess may result from the activity for which the organization was established or another activity. If an important part of the excess, though, is accumulated each year and the balance of accumulated excess at any time is greater than the organization's reasonable needs (see 14 below) to carry on its non-profit activities, profit may be considered to be one of the organization's purposes and the latter may then lose the benefit of the exemption provided in section 996 of the Act. This will be particularly so where assets representing the accumulated excess are used for purposes unrelated to the objects of the organization such as:

- (a) long-term investments to produce property income;
- (b) enlarging or expanding facilities used for normal commercial operations;
- (c) loans to members, shareholders or non-exempt persons; or
- (d) the accumulated excess is invested in term deposits or guaranteed investment certificates that are regularly renewed within a year and from year to year, whether or not the principal is adjusted from time to time.

14. The amount of accumulated excess considered reasonable in relation to the needs of an organization to carry on its non-profit activities is dependent on such things as the amount and pattern of receipts in the year from various sources. It is conceivable that there would be situations where an accumulation equal to one year's reasonably anticipated expenditures on its non-profit activities may not be considered excessive while in another situation an accumulation equal to two months' reasonably anticipated expenditures would be considered more than adequate. For example, a year-end accumulation equal to the following year's anticipated expenditures would probably be considered reasonable where an organization carries out its annual fund raising campaign at the end of its fiscal period. However, where an organization raises its funds on a regular basis throughout the year, it is generally not reasonable for the year-end accumulation to be in excess of an amount equal to its expenditures for one or two months.

15. A determination of whether the organization was operated exclusively for non-profit purposes in a particular taxation year must be based on a review of all its activities for that year. Such a determination is generally made at the end of each taxation year.