



CHRA CONGRESS SESSIONS SERIES 2016

**Advocating for Changes to the Federal Income Tax Act:
Improving the Financial Viability of Non-Profit Housing Providers**

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BC Housing

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Introduction

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The income tax act has requirements that non-profits must meet in order to acquire and maintain their tax-exempt status. In this period of reduced federal funding it is important that housing providers who are being encouraged to diversify their portfolios and revenue sources understand these requirements, as well as the potential outcomes and impacts. This panel examined the requirements to acquire and maintain a non-profit organization's tax exemption, and looked at the practical questions and concerns when considering revenue diversification – as well as to review pathways and possibilities for tax policy changes.

I. Tax and NPOs – The Problem

Margaret Mason, Partner, Charities and Tax Exempt Organizations, Bull, Housing and Tupper LLP (BC)

Bull Houser & Tupper LLP is a Vancouver-based law firm with over 125 years of experience providing legal advice to international and national clientele. While they provide services to corporate and individual clients, a significant area of focus includes offering legal advice to both charities and non-profit organizations (NPOs).

The eligibility requirements for maintaining tax-exempt status as a non-profit organization are not well understood, particularly within a sector that is being asked to continually adapt, diversify and grow. This difficulty is compounded by two common myths. The first being that an NPO, simply by virtue of its incorporation under the federal or provincial legislation pursuant to which non-profit organizations incorporate, is 'automatically' tax exempt. The second myth is that an NPO can conduct any revenue generation activity it wishes so long as the revenue it generates is applied to its social purposes. In reality, the only way an NPO can claim the tax exemption is if it meets the requirements of section 149.1(l) of the Income Tax Act (Canada).

This definition has four main criteria:

First, a NPO organization must, in the opinion of the Minister of National Revenue, not be a charity. This is often a difficult differentiation for NPOs to make since their actions and purposes may appear to be charitable, even if they are not a registered charity. At law, a charity must have a charitable purpose such as the relief of poverty, the advancement of education, the advancement of religion, or other purposes beneficial to the community (in a way the law regards as charitable). If a NPO has exclusively charitable purposes, for example to provide housing to the impoverished, then it will not qualify for the NPO tax exemption, and the only way it could claim a tax exemption would be to register as a charity. However, if a NPO

has both charitable and social purposes, then it could qualify for the NPO exemption. For example, the provision of affordable housing is a social purpose, not a charitable purpose.

The second criterion is that the NPO must be organized exclusively for a purpose other than for profit. This is typically not a problem for NPOs as being organized for this purposes is commonly fulfilled automatically if the NPO is incorporated under the provincial or federal legislation intended for the creation of social purpose entities.

Third, a NPO must operate exclusively for a purpose other than profit. Determining this can be difficult as budgeting for a surplus, having reserves in excess of reasonable needs, and fundraising or gifting to other entities are interpreted as indicators of the intentional generation of profits by the Canadian Revenue Agency (CRA). If any of these activities are evident, an NPO may not be eligible for tax-exempt status. Furthermore, the qualification for the exemption is made annually. This means that unlike a registered charity, a NPO has to qualify for tax-exempt status every year based on its current activities, and it is possible to qualify one year and not the next. Negative tax consequences may arise if a NPO does not consistently maintain its exemption.

Lastly, to maintain tax-exempt status, NPOs cannot directly distribute income generated from the organization to any of its members. While this is often understood as a straightforward requirement, there are less clear processes of distribution that could jeopardize tax-exempt status. Primarily, organizations must be careful if they provide subsidies to members, or decrease membership dues because of revenue generating activities, as these two actions could be an indirect “distribution” of the NPO’s revenue to members.

NPO’s need to be aware and take steps to ensure that they qualify for the exemption and do not undertake activities that have the potential to take them off-side.

II. Advocating For Clarity on Taxing Non-Profits

Brian Iler, Managing Partner, Iler Campbell LLP (ON)

Iler Campbell is a Toronto-based law firm providing legal expertise to corporate, commercial and not-for-profit clients. In working with the not-for-profit sector, Iler Campbell has found that the Canada Revenue Agency’s (CRA) current approach to interpreting the tax exemption for NPOs has had negative implications for NPOs.

The CRA is of the view that any profit generated from a NPO must be unanticipated, incidental and directly connected to non-profit objectives. To enforce these beliefs, letters stating this were widely distributed throughout the sector by the CRA. In these letters the CRA stated that accumulating capital was discouraged, even if it was to be used for non-profit purposes. In making these statements, the CRA upheld the troubling assumption that NPOs should not be engaged in economic activity. This belief ignores the reality that the way NPOs provide services is qualitatively different than the private sector, especially within the non-profit housing sector.

These distributed statements have created anxiety for NPO’s about whether or not organizational change and growth would make organizations ineligible for tax-exempt status. Although the CRA no longer distributes these letters, Iler Campbell notes that much of the confusion they created still persists. This has wide spread impacts on the sector as it makes NPOs and their CEOs reluctant to introduce changes in fear of losing their tax-exempt status. This concern stifles the innovation and boldness necessary for an organization to grow and meet the dynamic needs of their cliental.

To address this uncertainty, Iller Campbell advocates to policy makers for change that will encourage and promote the growth of the NPO sector. The first of these suggestions is that the CRA change their interpretation of tax-exemption. Iller Campbell first argues that the language of the exemption is clear, being that if a NPO's purpose and operations are exclusively other than for profit, and none of the income is available to members, then income is non-taxable. Yet this definition has been misconstrued by the CRA, who have not consistently upheld the tax-exempt status of all NPO's that meet this criteria. Iller Campbell suggests that in order for organizations to be unequivocally eligible for tax-exempt status, they should commit to apply their assets and energy to a purpose other than profit by doing three things.

First, NPOs must exclusively adopt a purpose that excludes pursuit of profit. Secondly, they must operate the organization for a purpose other than profit. Lastly, ensure income is not made available to members by creating a permanent asset lock, which is a legal measure that ensures organizations use assets for their stated purposes, rather than private gain. Iller Campbell argues that organizations structured this way are then unlikely to breach any of the requirements for tax-exempt status.

While these are actions NPOs can take, Iller Campbell also argues that legal precedent exists demonstrating that these actions affirm tax-exempt status. In *Gull Lake vs. the CRA*, a logging business was providing employment to members of its community, and re-investing the profits exclusively for the welfare of that community. The court ruled that logging company was not acting for the purpose of profit, and their tax-exempt status was upheld. In a second case, the CRA took Canadian Bar Insurance (CBI) to court over their tax-exempt status, stating that their accumulation of cash made them unqualified for tax-exempt status. Again, the court found that this action was conducted by the CBI for a non-profit purpose, and their tax-exempt status was similarly upheld.

While the CRA has not appealed these court rulings, it has refused to generally adopt the courts' reasoning. Instead, the CRA routinely scrutinizes organizations' operations, and implores discretion when considering tax-exempt status. However, Iller Campbell believes that the political climate is ripe for positive change given the results of the 2016 federal election. In the recent mandate letters sent to the Minister of Finance the Prime Minister wrote that it was time to "modernize the rules governing the charitable and non-for profit sectors."

To embrace this political atmosphere and clarify the tax-emption rules, Iller Campbell recommends an enforcement of the act that is consistent with the court rulings. When this is achieved they believe that the non-profit alternative can be encouraged, and facilitated for all forms of economic activity. It can then be a sector that is limited only by the imagination of their initiators, and by fundamental rule that non-profit surpluses are only applied to advance the social goals of which the organization was established.

III. Advocating for Change – Tax Treatment for Non-Profits

W. Laird Hunter, QC, Richards Hunter Toogood (AB)

Laird Hunter is a partner with the Edmonton-based law firm Richards Hunter Toogood. He provides legal counsel for real-estate, corporate commercial and non-profit clientele. Practicing since 1979, and appointed to the Queens Council in 2006, Laird has more than thirty-five years' experience in the field. He is widely recognized as a leading practitioner in non-profit law. During his career, Laird has addressed numerous issues relating to the non-profit sector, and recently he has advocated for change in the tax treatment of NPOs. In order to discuss how organizations can effectively introduce change, he describes the processes of public policy, and how organizations can use these processes to facilitate transformation.

It is important to understand the relationship of public policy and law, and how federal governments administer these policies. Public policy is based on the positions of the ruling political party and once these policies are expressed in legislation, government departments administer them. These departments fall within one of two categories; line departments or central agencies. Line departments perform duties given to them in a certain field, while central agencies develop the broad policy that informs line departments, and ensures policy coherence and coordination. In Canada, there are only four central agencies, one of which is the Department of Finance

The Canadian Revenue Agency (CRA) is not a central agency. Rather the CRA is a line department, tasked with administering the Income Tax Act, which is the responsibility of the Department of Finance. Expending resources to discuss change within the CRA itself is not fruitful, as the agency is not in charge of tax policy. Instead it is important to work with central agencies to reform broad tax policy in consultation with the CRA. However, in order to work with both Finance and CRA it is necessary to understand how and why tax policy is constructed.

Tax policy is broadly composed around four central questions: how much tax does the government need to pay for its expenditures (for example: child care and tuition); who should pay taxes and how much; what effect will taxes have on economic activity; and will taxes efficiently help economic transactions occur.

While these questions certainly have an economic focus, they also encompass the often forgotten notion that taxes have significant social benefit. This social benefit occurs through the distribution of tax expenditures, which includes tax exemptions. On average, Canada's total tax expenditure is approximately \$100 billion annually. To compare this with other cost expenditures, the federal government spends on average \$35 billion on health care, and \$83 billion on operating costs annually. Given the scale of tax expenditures, NPOs will be required to justify why they are worth the tax exemption to the new federal government.

To manage this, NPOs need to provide a clear explanation to policy makers about what goals they are targeting and why they hope to achieve them. To do this, organizations need to know whether they are targeting administration policy and the CRA, or the Income Tax Act directly. Furthermore, NPOs have to provide an assessment of their annual cost to the taxpayer and report on the quantitative and qualitative impact of their work to make both an economic and non-economic case for their tax exemption. Despite these requirements, Laird is optimistic that this government will usher in change for the tax treatment of NPOs.

In Summary

In conclusion, '*Advocating for Changes to the Federal Income Tax Act: Improving the Financial Viability of Non-Profit Housing Providers*' addressed a number of practical questions and concerns in consideration of revenue diversification for NPOs, along with possible pathways for tax policy change. It was concluded that the current federal government requires guidance rather than convincing in this area. Because of this willingness to listen, there is currently an opportunity for NPOs to lay the foundation for tax policy change, as long as the message is delivered coherently, and the social and economic aspects are justified.

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