



NONPROFIT ORGANIZATIONS COMMITTEE NEWSLETTER

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Canada Report: NPOs: Courts Continue to Show More Flexibility than the CRA

By Daniel Frajman

Canadian non-profit organizations (paragraph 149(1)(l) of the Canadian Income Tax Act) are facing regulatory difficulties with the Canada Revenue Agency which are in some ways more difficult than the regulations faced by Canadian registered charities (section 149 the Canadian Income Tax Act). Both Canadian non-profit organizations and Canadian registered charities do not pay income tax, but only Canadian registered charities can issue tax receipts for donations. The attached article deals with some of the regulatory difficulties being faced by the Canadian non-profit organizations.

This article, by Montreal attorney Daniel Frajman, of the firm Spiegel Sohmer Attorneys, first appeared in the Canadian Not-For-Profit News of April 2017 and The Canadian Taxpayer of February 24, 2017, which are edited by Arthur B.C. Drache, C.M., Q.C.. Reproduced by permission of Thomson Reuters Canada Limited.

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But what about one of the most common issues, alleged lack of control over assets which have been entrusted to an agent abroad. As most readers are aware, the vast majority of charities doing work abroad do so through the use of agency agreements. And one needs only to look at some of the decided cases to see that there can be great differences of opinion as to whether the arrangements meet the CRA standards. Of course, when the issue is litigated, the CRA always wins, given the deference shown to it by the Federal Court of Appeal.

In virtually every case we have seen and litigated, the directors believed they were acting in good faith and following the CRA's guidance, only to be told *ex post facto* that they were wrong. This often results in a revocation.

Do the directors become "ineligible"? Is the failure of an agency agreement "serious"? The fact of the matter is that if one reads the guidance, it is clear that the Charities Directorate may or may not deem a director to have become "ineligible". And that vagueness is what is bothersome.

We have recently seen a case where a new director of a small charity who had not been involved in setting up the agency agreement or being "hands on" enough to know whether it was being adhered to, found himself in a situation where the organization was about to have its registration revoked.

There won't be an appeal of the revocation. But the individual is also the member of several other boards, all of them fairly large and very public. If he is deemed to be "ineligible" because of the revocation of the one small charity, will the other charities get letters from the CRA telling them that he is ineligible? If this happens, an active volunteer and donor will be hugely embarrassed in front of his peers.

But there is no way, until the CRA indicates the position it will take, for him (or his legal advisers) to make a judgment as to whether his status is at risk. Perhaps the prudent thing for him to do is quietly resign from all his boards as a precaution and to preserve his reputation. If he does so, the community has sustained a significant loss.

It seems to us that more thought should be given to how situations where there is no breach of the law or moral lapses, can be better handled. Unfortunately, that is not likely to happen.

NPOs: Courts Continue to Show More Flexibility than the CRA

Daniel Frajman

Top of mind for many is whether the government will soon be making changes to the legislative framework for non-profit organizations (NPOs). Such changes may be premature, given that the government's promised consultation on NPOs does not

appear to have been completed. However, if change does come, it will hopefully take account of court decisions in the area, both at the federal and provincial level, that have shown more flexibility towards NPOs than the CRA in its interpretations. We will below briefly refer to the consultation and the interpretations, and to two of the major court decisions, including the recent decision of the Court of Quebec, *Coop publicitaire des concessionnaires Chrysler Jeep Dodge du Québec v. Agence du revenu du Québec* ("Coop").¹

Since at least 2009,² the CRA has issued several technical interpretations and statements showing a narrow interpretation of activity that is acceptable for an NPO. The legislative definition of an NPO, essentially unchanged since 1917, is at paragraph 149(1)(l) of the *Income Tax Act* (Canada), indicating in essence that (i) an NPO must be operated "for any purpose except profit", and (ii) none of the NPO's income may be payable to or otherwise available for the personal benefit of any proprietor, member or shareholder of the NPO. Most of the CRA's recent interpretations have focused on the first of said criteria, i.e., whether the organization operates for a profit purpose.

The CRA's recent positions seem narrow in that they essentially say that if an NPO earns profit, the profit should be unanticipated and incidental, possibly that whether profit is earned is evaluated on a project by project (or division by division) basis rather than by looking at all of the organization's operations together, that activities would normally be carried out on a cost-recovery basis and that unreasonably high accumulated surpluses are to be avoided.

In the 2014 federal budget, the government announced a public consultation on the income tax framework and reporting requirements for NPOs (not charities). A few days later, the CRA released a short report titled, "Non-Profit Organization Risk Identification Project", which essentially indicated that the CRA had reviewed over 1,300 NPOs over the previous three years to research tax compliance in the non-profit sector, a significant number of such organizations would in the CRA's view fail to meet at least one of the requirements for being an NPO, the CRA would work to improve NPOs' understanding of their obligations through outreach, client service and education, and "because... the legislative framework may benefit from further examination, a copy of this report will be provided to the Department of Finance Canada for information and consideration". To date there has been to our knowledge no consultation process and report thereon on the framework for NPOs, and no legislative proposals.

As regards greater flexibility in the courts, we look first at the Tax Court of Canada's 2008 decision in *BBM Canada v. The Queen* ("BBM").³ *BBM* concerned an organization assembling survey data relating to radio and television listening and viewing habits, with the surveys made available to its members, being both public

1 2016 QCCQ 11252, 2016 CarswellQue 9576.

2 CRA Views 2009-0337311E5, "149(1)(l) organizations", November 5, 2009.

3 2008 TCC 341, 2008 CarswellNat 1844, [2009] 1 C.T.C. 2117.

and private broadcasters. The Court found the BBM organization to be operating for a purpose other than profit, and to therefore be an NPO. It appears instructive to quote the following from Justice Boyle's decision in *BBM*:

[46] It has long been CRA's view, published in Interpretation Bulletin IT-496 "Non-Profit Organization", that some things, such as the realization of significant profits or the accumulation of unreasonable reserves can be evidence of an unstated profit purpose. Other relevant considerations set out in the Bulletin are whether the entity's activities are operated in a normal commercial manner, whether goods and services are sold to non-members, whether it is operated on a profit basis rather than a cost recovery basis and whether it operates in competition with taxable entities carrying on the same trade or business. I agree that, in appropriate cases, these may be reasonable and relevant considerations, though they cannot all be requirements, they must be weighed appropriately in the circumstances of each case, and none will be determinative. However, in this case their consideration does not lead me to conclude BBM has an unstated profit purpose.

[47] The Crown has conceded BBM's reserves over the years were reasonable in amount relative to the needs of their operations.

[48] BBM operates on a cost recovery basis over the medium and long term even though it does not operate on a cost recovery basis each year. If its reserves are reasonable in relation to its needs, this means the reserves will be spent within a reasonable period.

[49] If its reserves are reasonable and it operates on a cost recovery basis, it would be hard to say an organization realizes significant profits.

[50] BBM only sells its data to its members. It would be difficult to impute a profit purpose to an organization that only sells to members on a cost recovery basis...

[52] Caution needs to be taken with the Bulletin's consideration of whether the operations are operated in a normal commercial manner...With respect, that is not what I would consider sufficient to put an organization offside...It is the public sector, governments and quasi-governments, and the non-profit and charitable sectors that need to be reminded they should be business-like in their operations and delivery of services.

[53] [Rather, the] operations of not-for-profit entities like BBM lack a significant attribute of commercial businesses. There is no opportunity for their shareholders, members or controlling persons to benefit financially by way of profits, distributions, unrestricted salaries, capital appreciation of the undertaking or its assets, or in similar fashion.

BBM also refers to a proper way of effecting a change in the law, as follows (at paragraph 41):

If a revision [to the law] is needed it should be left to a possible legislative change which would only be done after a review of the need for such a change was done by persons responsible for tax policy, aware of the depth and breadth of the sector..., aware of all of the fiscal impacts beyond the application of paragraph 149(1)(l) of the *Income Tax Act*, and which would allow for the possibility of

consultation. Canadians, Canadian society, the provinces and the non-profit sector deserve as much.

The recent *Coop* case applies and approves *BBM*. The NPO co-operative in *Coop* provided promotion and publicity services to its members (certain automobile dealers in Quebec), with each member contributing funding to the co-op based on the number of vehicles purchased from the automobile manufacturer. The Court of Quebec was considering sections 986 and 996 of the *Taxation Act* (Quebec), which are essentially identical to paragraph 149(1)(l) of the *Income Tax Act*. The Court held that the co-op was an NPO, and stated as follows:

- the co-op is seeking to recover its costs; an annual operating surplus is used to finance the next year's activities;
- the co-op's funds are not distributed to its members as profits or rebates;
- the legal situation of the co-op is analogous to that of *BBM*; the CRA's position in *BBM* was dismissed and the *Coop* case does not justify a different decision;
- it is permissible for the co-op to file as a non-profit in the year in question, and not as a non-profit in other years.

Therefore, the courts are following a wider view as to what is an NPO, as compared to administrative positions of the tax departments, and the tax departments should be following the lead of the courts. For its part, Finance's consultation on the legislative framework for NPOs does not appear to be complete, so legislative change, especially if it is aimed at overturning the position of the courts, seems to be premature.

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Publicizing Massive Gifts: Potential Pitfalls

A few months ago we attended a seminar for directors of museums and galleries sponsored by the Canadian Museums Association. Over lunch at our table, the conversation turned to the topic of some of the huge gifts which had been made to Canadian institutions (not just museums) in the past year or two.

The talk was triggered by a full page ad in the *Globe and Mail* publicizing one such gift to the National Arts Centre in Ottawa.

The question was raised as to whether such publicity was counter-productive.

Given the attendees at the seminar, everyone agreed that working to get such gifts was a key goal of all fundraisers. And they all agreed that if the donors agree, it was great publicity for the organization to let the public know that this level of support had been given...particularly when the gift was not tied to a specific