

NOT FOR PROFIT ALERT

GST/HST SERIES

Fundraising Activities and GST/HST

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Fundraising activities whether through sale of tickets to events or sale of goods, represent an important source of funding for many charities and not-for-profit organizations ("NPOs"). Generally such activities are taxable supplies under the Excise Tax Act ("ETA"), but special rules apply for charities, public institutions, and NPOs.

As the ETA treats fundraising activities conducted by charities and public institutions and NPOs differently, one first has to understand the ETA's definition of such entities.

Charities & Public Institutions

The ETA defines charities as an entity that is a registered charity or a registered Canadian amateur athletic association as defined in the Income Tax Act ("ITA"). A public institution is defined as a registered charity that is a school authority, public college, university, hospital authority, or a local authority that is a municipality. All of these entities have their own definitions in the ETA.

NPOs

Unlike charities and public institutions, the definition of an NPO is broader and means an entity that is operated for a purpose other than generating a profit and it is not a charity, public institution, individual, estate, or trust.

Sale of Tickets to Fundraising Events

Charities & Public Institutions

For the sale of tickets to fundraising events, the GST/HST treatment is the same for both charities and public institutions. If part of the consideration for the ticket is regarded as being donated to the charity or public institution and a donation receipt is available under the ITA, then the full price of the ticket will be exempt from the GST/HST.

With the event being a GST/HST exempt supply, there are no GST/HST input tax credits to claim on event-related expenditures. Instead the charity

or public institution will claim the Public Service Bodies' rebate which will only recover a portion of the GST/HST cost incurred.

NPOs

Unlike charities and public institutions, tickets to fundraising events held by NPOs are subject to the GST/HST. The advantage for NPOs is that with the events being a taxable supply, there are input tax credits available to recover the full GST/HST cost incurred on event-related expenditures.

"...special rules apply for charities, public institutions, and NPOs."

Fundraising Events for the Benefit of a Charity or Public Institution

For fundraising events organized by an NPO or other entities where the proceeds are being donated to a charity or public institution, the tickets are subject to the GST/HST provided the organizer is registered for GST/HST. The rationale is that the NPO or other entity which is organizing and selling the tickets to the event is not considered to be the charity or public institution's fundraiser and, hence, is not subject to the exemption from the GST/HST.

Sale of Goods & Services as Fundraisers

Charities & Public Institutions

For charities & public institutions, most goods and services sold through the course of non-recurring fundraising activities are exempt from the GST/HST. The activity has to be non-recurring as goods and services which are supplied through the course of the charity or public institution's regular activities are not GST/HST exempt. Furthermore, if the sale entitles the buyer to receive goods and services on a regular basis throughout a year, the supply is not exempt from the GST/HST.

NPOs

Generally, supplies of goods and services by an NPO are subject to the GST/HST, but the ETA does allow for certain exceptions. Fundraising sales of goods by volunteers where the consideration for each item

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is less than \$5 is GST/HST exempt provided the following criteria are met:

- The entity is not in the business of selling such goods
- The salespeople are all volunteers
- The goods are not alcoholic or tobacco items
- The goods are not being sold at an event where the goods are being sold by persons in the business of selling such goods

An example of such exempt activities would be a bake sale held by an NPO to raise funds.

Bingo and Casino Events

For charities, public institutions, and NPOs, the supply of admissions to a bingo or casino event is GST/HST exempt provided the event is being run exclusively by volunteers and it is not being held at a place used primarily for the purpose of conducting gambling activities, like a casino or bingo hall.

We have seen different forms of fundraising and fact patterns (including ones that have some sort of auction) that do not fit the exact rules noted above and one should consult with an experienced indirect tax advisor to determine if they are entitled to a refund or have not exposed the entity to a liability! §

Modifications to the Registered CHARITY INFORMATION RETURN

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The March 2010 Federal Budget (“the Budget”) resulted in changes to Form T3010-1, the Registered Charity Information Return, that charities must file annually with the Canada Revenue Agency (“CRA”). The changes apply to all registered charities for taxation years ending after March 3, 2010, and have reduced the compliance burden put on charities as some of the more complex rules in the Income Tax Act have been modified and, therefore, will simplify the process of completing a Registered Charity Information Return.

Disbursement Quota

As discussed in our June and December 2010 *NPO Alerts*, the most significant 2010 Budget change was to effectively eliminate some of the complex reporting requirements associated with the disbursement quota (“DQ”). Under the DQ rules, annual expenditures on charitable activities (including gifts to other charities), had to exceed a minimum of 80% of the prior year’s receipted donations plus other amounts relating to “enduring property” and transfers between charities. The Budget eliminated many of the requirements of the DQ thereby eliminating related concepts such as “enduring property”, “specified gifts” and “capital

gains pool”, as these were primarily relevant for determining if the DQ had been met.

As a result, the most significant change to the annual filing requirements for charities is the elimination of form T1259 – Capital Gains & Disbursement Quota Worksheet. This also resulted in the elimination of the need to provide the following information on Schedule 6 of the annual return.

Revenue

- Line 4520 – Total specified gifts from other registered charities
- Line 4525 – Total enduring property from other registered charities
- Line 5640 – Total eligible amount of tax receipted enduring property

Expenditures

- Line 5060 – Total amount of enduring property transferred to qualified donees;
- Line 5070 - Total amount of specified gifts made to qualified donees;

Enduring property and the capital gains pool

- Line 5710 – The fair market value of all enduring property spent during the fiscal period

- Line 5720 – The capital gains from the disposition of enduring property in the fiscal period
- Line 5730 – Is the charity claiming an amount that is less than the maximum capital gains reduction?
- Line 5740 – If Line 5730 is yes, enter the amount from line 11 of Form T1259, Capital Gains and Disbursement Quota Worksheet

While most of the DQ has been abolished, a section of the DQ which has survived is “the capital accumulation rule”. This rule requires charities to spend on charitable activities in each year (above and beyond the former 80% “expenditure rule”) 3.5% of the average fair market value of the charity’s assets that are not used directly in its charitable activities or administration in the 24 months

immediately preceding the taxation year. The 3.5% test was previously applied to the value of the investment assets in excess of \$25,000. While the threshold for public foundations remains at \$25,000, the Budget increased it to \$100,000 for charitable organizations. This change does not result in any reporting change on the annual return.

Summary

While the elimination of the DQ and the increase in the “capital accumulation” threshold will ease the compliance burden somewhat for charities, the annual return still requires significant amounts of information. This is not surprising given that the CRA still has to administer the charitable sector to ensure it is complying with the spirit of philanthropy in the country. Nonetheless many charities will find the changes to the annual return a welcome relief. §

Profits Earned BY A NOT-FOR-PROFIT ENTITY

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The *Income Tax Act* provides an exemption from income tax for “a club, society or association ... that was organized and operated exclusively for social welfare, civic improvement, pleasure or recreation or for any other purpose except profit”.

For many years, these organizations have relied on CRA guidelines provided in Interpretation Bulletin IT-496R – Non-Profit Organizations. The Bulletin indicates that it is a question of fact whether a particular organization operates exclusively for any purpose except profit. However, it does conclude that an organization can earn revenues in excess of expenses provided that it does not accumulate a material part of the excess each year and that the balance of the accumulated excess at any time does not exceed its reasonable needs to carry on its non-profit activities. Furthermore, the Bulletin concedes that accumulating surplus funds in excess of current needs will not affect its tax exempt status where the organization requires time to accumulate funds needed to acquire a capital property that will be used to support its declared exempt activities. In practice many organizations interpreted this

to mean reserves of six to eight months worth of expenditures was an acceptable practice.

There have, in the past couple of years, been opinions expressed by CRA in published technical interpretations that could be viewed as expressing an opinion contrary to that in IT-496R. For example, in one opinion letter, CRA indicated that an NPO may earn a profit, but only if that profit is generally unanticipated and incidental to carrying out the entity’s not-for-profit purposes. It may not intentionally earn a profit to finance future capital projects, nor may it accumulate excess funds to earn investment income that will be used to finance ongoing expenses, even if those funds were accumulated from members’ contributions. In addition CRA indicated it might impose strict limits on budgeting for a surplus and in the event that an organization earns a profit, it should be ancillary and incidental to the organization’s purposes.

These opinions have created uncertainty for many NPOs. For example, if a recreational club earns income from renting out its facilities for weddings and banquets, will it now lose its status as an NPO?

Bottom Line

These are new, restrictive interpretations on profits earned by an NPO that are inconsistent with current practice. We have also been informed that CRA has increased the numbers of auditors servicing reviews of NPOs.

In response, NPOs need to exercise caution in the planning and budgeting process, ensuring they follow a zero budgeting model or document the allocation of profit to a specific purpose or restricted fund that falls within the NPOs original mandate. §

June 6, 2011 FEDERAL BUDGET

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On March 22, 2011 the minority Conservative federal government introduced its 2011 budget in the House of Commons. This budget died when Parliament was dissolved on March 26, 2011.

The Minister of Finance has now tabled a second 2011 budget on June 6, 2011 which includes all of the measures that had previously been introduced, along with a couple of additional provisions related to Quebec sales tax harmonization, and the suspension of support for political parties. The June budget even preserves the effective dates of the legislative changes that had been introduced in March.

Unlike the 2010 Budget, this Budget did not contain any measures to further reduce the regulatory burden on Canadian not-for-profit organizations. Quite the contrary – there are a number of provisions which will impose stricter compliance requirements for not-for-profit entities. These appear to be mainly aimed at curtailing the use of not-for-profit organizations for tax avoidance and tax shelter purposes. A brief overview of these provisions is included below.

Qualified Donees

The budget extends many of the regulatory requirements that currently exist for registered charities to other entities that can issue donation receipts (“qualified donees”). This would include registered Canadian amateur athletic associations (“RCAAAs”), municipalities, housing corporations and universities outside Canada. These entities will now be required to maintain proper books and records, and will be listed on the publicly available list of qualified donees maintained by CRA. In addition, receipting privileges or its qualified donee status will be revoked if the entity does not comply with the Income Tax Act.

Governance Control

New rules were introduced that give CRA the right to refuse or revoke the registration of an organization or to suspend its right to issue donation receipts if an individual involved in the management or control of the organization has been found guilty of a criminal or other offence involving financial dishonesty, or was a promoter of a donation tax shelter involving a charity that was revoked in the past five years.

Gifts of Non-Qualifying Securities

Anti-avoidance provisions have been introduced to prevent abusive tax avoidance where a person makes a donation of securities of an entity which does not deal at arm’s length with the donor. This type of security is referred to as a “non-qualifying security”. The new rules provide that the person will not receive a donation receipt at the time of the gift. Rather, the donation receipt can only be issued when, within five years of the gift, (i) the qualified donee sells the non-qualifying security (for consideration other than another non-qualifying security of the donor), or (ii) the gift no longer qualifies as a non-qualifying security.

Gifts of Flow-Through Shares

Gifts of publicly listed securities to a charity receive preferential tax treatment because the capital gain arising on the gift is exempt from tax. However, owners of flow-through shares also receive a deduction for tax purposes equal to the cost of the shares in the year acquired. These shares have a nil cost for tax purposes, and the subsequent donation of those securities on a tax exempt basis to a charity has been perceived as a form of “double dipping”. As a result, rules have been introduced to limit the amount of the exempt capital gain on the donation

of flow-through shares to the excess of the amount of the donation receipt over the original cost of the shares. Since the value of flow-through shares rarely increases over the original cost, this has effectively closed this form of tax relief.

Options

Where a person grants an option to acquire property to a qualified donee, a tax receipt can be issued for the value of the option. Measures have now been introduced to delay the ability to receive a donation receipt until the donee actually acquires the property from the donor, provided the amount paid by the donee for the property and for the option (if applicable) is less than 80% of the fair market value of the property. If the amount paid exceeds 80% of the property's fair market value, there is no gift, unless the donor can establish to the tax authorities that the granting of the option and the disposition of the property was intended to be a gift. A sale of the option by the donee will also allow it to issue a receipt for the proceeds of sale in excess of the cost of the option.

Registered Canadian Amateur Athletic Associations

The budget introduced provisions that will apply specifically to RCAAAs. While registered charities are required to operate "exclusively" for charitable purposes, RCAAAs currently only need the promotion of amateur athletics in Canada to be their "primary" purpose. The budget changes this to require RCAAAs to be "exclusively" organized for this purpose. In addition, RCAAAs will also have to comply with certain other provisions applicable to registered charities, such as restrictions on business and political activities, and the provision of public access to information such as annual information returns, names of directors, governing documents, etc.

This is a brief summary of the budget provisions applicable to not-for-profit organizations. Detailed analysis of the provisions is contained in the Collins Barrow March 2011 Budget Newsletter available on our website. §

USEFUL TIP

Charity Tax Tools (<http://Charitytax.imaginecanada.ca>) is a free comprehensive information website by Imagine Canada that will provide Canadian charities with useful information to ensure all CRA requirements are being met. §

Collins Barrow publishes a quarterly NPO Newsletter for its clients and associates. While the NPO Newsletter suggests general planning ideas and technical updates, we recommend professional advice always be sought before taking specific planning steps.

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