

Tax agency program targets NPOs

By DONALEE MOULTON

Many non-profit organizations (NPOs) across the country have recently found a missive from the Canada Revenue Agency in their mailbox, reminding them of their tax obligations and, in some cases, warning them they may not be compliant.

The letters are part of a three-year CRA research program launched in 2010. According to the national tax agency, the intent of the Non-Profit Organization Risk Identification Project is to learn more about the way NPOs operate under the provisions of the *Income Tax Act*.

The CRA has identified about 39,000 NPOs that file returns. This year, 480 organizations will be audited, bringing to 1,440 the total number of NPO reviews over the past three years.

"Traditionally, not for profits have fallen through the reporting cracks of the CRA," said Adam Aptowitz, a partner with Drache Aptowitz in Ottawa. "Unlike charities and for-profit entities, not-for-profits only need to file if they meet certain minimum thresholds. As a result, the CRA did not have a great handle on the extent of the sector."

There were unconfirmed concerns that for-profit organizations could be using non-profit status to avoid paying taxes. The

impact on non-profits in Canada. "NPOs are nervous," said Parks. "A lot are looking at if they should restructure themselves."

That option is not as simple as it sounds. Thorny questions need to be answered, such as whether a money-making trade fair hosted by an NPO constitutes a "purpose" of the organization, or is simply an activity — the latter is allowed, but the former is verboten. "These are the things lawyers agonize over and makes clients pull their hair out," said Parks.

The angst dates to the initial release of education letters last year. The intent was to generally remind organizations of their "compliance obligations" under the tax act, said Linda Godel, a lawyer with Torkin Manes in Toronto. However, she pointed out: "The CRA stopped sending these letters ... as a result of concerns expressed by the non-profit sector."

In fact, the letters confused the sector. Organizations audited by the CRA as part of the research program were not sure if they were being accused of something, cautioned against a particular activity, or simply being informed. More recent letters, sometimes called audit summaries reports, have gone a step further, stating that NPOs may not qualify for their non-profit

status and outlining where they may be non-compliant. "The CRA instructed these non-profits to cease these concerning activities failing which the non-profit could lose its tax-exempt status," said Godel.

But it wasn't always clear what needed to be stopped. Parks has a client that may not qualify because of surplus funds, which according to the letter sent by CRA cannot be excessive. "That's like saying: 'Just be beautiful,'" Parks said.

On the punishment spectrum, education letters are on the lenient end of the continuum. "The CRA has several different ways of responding to deficiencies on an escalating scale of severity and consequence. An education letter is the first, and

most benign, way that the CRA will communicate with a non-compliant NPO or registered charity," said Anna Naud, a senior associate with Borden Ladner Gervais in Toronto.

"Apparently, the CRA feels that this is more cost-effective than pursuing other actions," said Aptowitz. "Given that there are no real ramifications to the letter, except perhaps red-flagging the organization for a future audit, there may also be a sense that a letter is more politically palatable than taking steps which would shutter prominent community organizations."

Regardless of the purpose of the letters, the outcome is clear, said Parks. "There is a chilling effect. The community is being very cautious."

Defining a non-profit

What exactly is an NPO? The answer to that question will not be found in the *Income Tax Act*. However, according to the CRA, here are strong hints an organization is a non-profit if:

- None of the income earned by the organization is available for the benefit of its members.
- The organization is not a charity.

exclusively for social welfare, civic improvement, pleasure or recreation, or any other purpose except profit.

It files under paragraph 149(1)(i) of the act.

• It is a club, society, or association organized and operated

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issue potentially arises in "hybrid" situations, for example, such as a 20-floor building that operates as a hotel on 10 floors and a condo on the remaining 10 floors. Condo corporations fall under the non-profit banner; hotels do not.

The murky ground can be traced to the section of *Income Tax Act* that covers NPOs. "This section is pretty antiquated," said Jim Parks, a partner in the tax and trusts group with Cassels Brock & Blackwell in Toronto.

It's not clear whether the CRA's project was prompted by a desire to modernize the tax act, but the initiative is having an

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