

# CRA Letter on Unincorporated Associations & paragraph 149(1)(1)

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Please note that the following document, although believed to be correct at the time of issue, may not represent the current position of the CRA. Prenez note que ce document, bien qu'exact au moment émis, peut ne pas représenter la position actuelle de l'ARC.

PRINCIPAL ISSUES: If an unincorporated association that has claimed a tax exemption under paragraph 149(1)(1) is found not to qualify for this exemption who is taxable on the income earned by the unincorporated association?

POSITION: Likely the members of the unincorporated association

REASONS: The unincorporated association is not a "person" for purposes of the Act; thus the income would be attributable to its members.

July 30, 2010

Compliance Programs Branch

Attention: Rubin Dressler

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2010-036970

Unincorporated Associations and Paragraph 149(1)(1) of the Income  
Tax Act

This is in response to your email of June 2, 2010, in which you asked for our views on the above-noted topic. Specifically, you asked who should be assessed for tax on the income earned by an unincorporated association (an "Association") that is found not to meet the requirements for the tax exemption provided by paragraph 149(1)(1) of the Income Tax Act (the "Act").

#### Fact Scenario

You indicated that there is not a current situation under audit from which you could provide us with specific facts. Instead, you provided the following general scenario:

\* An Association self-assesses as exempt from tax under paragraph 149(1)(1) of the Act.

\* As it is not incorporated, the Association does not file income tax returns.

\* The Association has assets worth more than \$200,000, thus it files a T1044 Information Return as required by subsection 149(12) of the Act.

\* The Association is audited and it is determined that the Association does not meet the requirements of paragraph 149(1)(1) as it has been operated for a profit purpose.

#### Issue

Who should be assessed for income tax on the income earned by the Association?

#### Our Comments

##### Liability to pay tax

The Act generally requires that every person resident in Canada pay tax on their world-wide income; a person not resident in Canada is liable for tax on any income earned from a Canadian source. Thus, in order to be liable to pay tax, an Association must be a "person" for income tax purposes. A person is defined in subsection 248(1) of the Act as follows:

"Person, or any word or expression descriptive of a person, includes any corporation, and any entity exempt, because of subsection 149(1), from tax under Part I on all or part of the entity's taxable income and the heirs, executors, liquidators of a succession, administrators or other legal representatives of such a person, according to the law of that part of Canada to which the context extends;"

Based on this definition, an Association exempt from tax under paragraph 149(1)(1) of the Act is a person for purposes of the Act, despite the fact that it is not a legal entity. Such an Association is subject to the applicable provisions of the Act as though it were an entity separate from

its members with its own income and property. However, a problem arises once it is determined that an Association does not meet the requirements of paragraph 149(1)(1). In our view, the Association ceases to be a "person" from the time that it no longer qualifies for the tax exemption (assuming no other provision of the Act otherwise applies). If the Association should later meet the criteria of paragraph 149(1)(1), then it would once again be a "person" for purposes of the Act.

Who is liable for tax on income earned by the Association?

Once it is determined that an Association does not meet the requirements of paragraph 149(1)(1) of the Act, it is our view that the Association is no longer a "person" for purposes of the Act and, therefore, is not itself taxable as a separate entity (unless it is considered to be a person under some other provision of the Act). If income was earned by the Association, we want to ensure that this income is taxed. To tax this income, the income must have been earned by either a taxable entity or an individual. It may be that the Association is a taxable entity, even though it is not a legal entity. For example, the members of the Association might have created a trust at the time the Association was established. If this is the case, then the Association would be taxable on any income it earned, as a trust is a taxable entity. If the Association is found not to be a taxable entity, then the income earned by the Association would belong to its members. The issue then would be whether the income is taxable to those members. In order for the income to be taxable to the members it must generally be "income from a source". Common sources of income include employment income, business income and income from property; there are also certain types of payments that the Act taxes by specific reference, for example, amounts listed in sections 12 and 56 of the Act.

In order to determine whether the Association is a taxable entity, the relationship between the Association and its members, and especially the relationship between the members, must be considered. Any by-laws, mission statements, or statements of objects should be reviewed, along with any minutes of meetings or planning documents that are available.

Specifically we are interested in the members' intentions and undertakings, especially at the time of the creation of the Association.

Although we cannot provide you with a detailed analysis, below we have set out some of the possible types of structures that you may encounter.

#### Trust

The members might have established a trust at the time that the Association was created. In order to establish a trust under common law "three certainties" must be met: certainty of intention (i.e., intention to create a trust); certainty of subject matter (i.e., the item or money to be put in trust is clearly indicated); and certainty of objects (i.e., it is clear who will benefit). All three of these criteria must be met in order for a trust to exist.

It is possible that particular members of an Association could be considered the trustees and settlors of a trust. The membership fees (or other amounts contributed to the Association) could be the property settled on the trust. The beneficiaries could be those who would benefit from the services or products offered by the trust. If it can be established that a trust has been created, then the trust would be required to file a tax return and would pay tax on any income that it has earned but that is not paid or payable to its beneficiaries.

In our view, it is unlikely that a situation would arise that would support the finding that a trust had been created under the circumstances you described. In most instances, it would be difficult to show that the requirements to form a trust at common law had been met.

#### Partnership

Generally, a partnership is defined as two or more people acting together with the intention of earning a profit. Based on this definition, a partnership cannot qualify as a 149(1)(1) entity because of the partnership's profit-making goal. However, in our view, if the Association did not qualify as a 149(1)(1) entity because it operated with a profit purpose (which is the scenario you outlined), an argument could be made that the Association was in fact a partnership. If this were the case, then the regular partnership rules would apply as set out in the Act (generally, section 96 of the Act and related provisions). It should be noted that a partnership is not itself taxable, however, the partners are taxed on income allocated to them under their partnership agreement. As it is unlikely that the members would have a written partnership agreement, under the circumstances, income might have to be allocated based on each member's interest in the Association as determined by contributed amounts and services provided to the Association (i.e., general partnership principles and possibly statutory provisions would apply).

In considering the issue of whether a partnership exists, the courts appear to put more emphasis on the actions of members than on written documents. This suggests that even if an Association's by-laws or other constating documents suggest a lack of intention to create a partnership, this intention may be ignored in face of evidence based on the actions of the members. In other words, if the members operate the Association in the manner of a partnership, then it is likely that this will be accepted by the courts as evidence of the existence of a partnership.

#### Joint Venture

Mr. David A. G. Birnie, in the article "Partnership, Syndicate and Joint Venture: What's the Difference" notes that there is not a clear definition of a joint venture. According to this article, a joint venture appears to be "an association of two or more persons for a given limited purpose without the usual powers, duties and responsibilities that go with partnership". (footnote 1) The author suggests that the intention of the parties that enter into this relationship is key-either they intend to

create a partnership or they intend to create something else which may be a joint venture.

If an Association was created by a group of members, but it is found that no partnership exists, it may be that the group has undertaken a joint venture. Unlike a partnership, a joint venture does not appear to require that the members involved intend to "earn a profit". Therefore, the coming together of the members to undertake the activity in question may be sufficient to result in the establishment of a joint venture.

The Act taxes partnership income differently than income from a joint venture. Although it is not a separate taxpayer, the Act allocates income to a partner after first determining the partnership's income. This means that expenses are generally deducted at the partnership level and the net income is then allocated to the partners in accordance with the partnership agreement. In a joint venture, revenue is generally allocated before expenses are deducted. Members deduct any expenses that they incurred to earn their share of the joint venture income from the revenue allocated.

#### Only One Member

If there is only one member of the Association, then any income earned by the Association is the income of the member, since the Association generally will not be a separate taxable entity. Thus, the member should be taxed on the income, with any expenses allowed depending on the nature of the income. The nature of the income must be determined on a case-by-case basis. The income could be, for example, business income, income from property or capital gains. As mentioned above, special provisions such as those found in sections 12 and 56 of the Act should also be considered if more general provisions do not apply.

#### Conclusion

An Association does not exist as a separate legal entity from its members. However, an Association may be a "person", and therefore a separate taxpayer for purposes of the Act, if it meets the definition of "person" contained in the Act. If the Association does not meet this definition (in your scenario, because it is not a 149(1)(1) entity), then in most cases it is not a separate taxable entity; for purposes of the Act, its income or losses belong to its members in some way. The members may be taxable on the income, if the income is "from a source" and the members are themselves taxable entities. Similarly, the losses may be available to the members to be used to reduce income from other sources (if allowable). In our view, an Association with more than one member that is not a separate taxable entity will most often be a partnership or a joint venture.

We hope that these comments will be of assistance.

For your information, unless exempted, a copy of this memorandum will be severed using the Access to Information Act criteria and placed in the Canada Revenue Agency's electronic library. A severed copy will also be

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Requests for this latter version should be made by you to Mrs. Celine Charbonneau at (613) 957-2137. In such cases, a copy will be sent to you for delivery to the taxpayer.

Yours truly,

Eliza Erskine  
Manager  
Non-Profit Organizations and Aboriginal Issues  
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Income Tax Rulings Directorate  
Legislative Policy and Regulatory Affairs Branch

#### FOOTNOTES

Note to reader: Because of our system requirements, the footnotes contained in the original document are shown below instead:

1 Definition from Encyclopaedic Diction of Business Finance, as quoted in "Partnership, Syndicate and Joint Venture: What's the Difference", by David A. G. Birnie, 1981 Canadian Tax Foundation page 182 at page 182.