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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: XXXXXXXXXXXX . 1. What happens when a 149(1)(1) entity no longer qualifies for the tax exemption? 2. What steps must be taken when this occurs? 3. For how many years can an assessment be raised? 4. Does the case Edmonton Badminton Club v. MNR affect this situation? 5. How does subsection 149(10) apply? 6. Is the CRA required to audit a 149(1)(1) entity each year?

POSITION:1. Subsection 149(10) applies if the entity is a corporation. The result is a deemed year end for the corporation and the disposition and reacquisition of all of the corporation's assets immediately before the time 149(10) applies. Also affects the corporation's ability to carry forward losses and other balances or reserves. 2. No formal steps. 3. Subsection 152(3.1) applies unless there is a misrepresentation in which case subsection 152(4) may apply. 4. This case does not apply to restrict an assessment. 5. Subsection 149(10) applies to a corporation such that it is considered a "new" corporation after that time and the next tax return filed is considered its first tax return. 6. No.

REASONS: 1. Provisions in the ITA. 2. Provisions in the ITA. 3. Provisions in the ITA. 4. The case was dismissed due to the Crown providing insufficient evidence to support its case. 5. Provisions of the ITA. 6. Provisions of the ITA.

March 10, 2010

Compliance Programs Branch HQ  
Rulings

HEADQUARTERS  
Income Tax

Directorate  
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Attention: Michael Hamilton

2010-035583

XXXXXXXXXX

This is in response to your email of January 28, 2010, in which you forwarded questions from the Winnipeg Tax Services Office regarding our comments with respect to XXXXXXXXXXXX and whether this corporation qualifies for the exemption from tax provided by paragraph 149(1)(1) of the Income Tax Act (the "Act") XXXXXXXXXXXX . We have only addressed those questions regarding the application and interpretation of the Act. We understand that your area will address the audit issues.

1. What are the tax consequences of losing a 149(1)(1) exemption?

In general terms, paragraph 149(1)(1) of the Act provides that the taxable income of an organization that is a club, society or association is exempt from tax under Part I of the Act for a period throughout which the organization meets all of the following conditions:

- \* it is not a charity;
- \* it is organized and operated exclusively for social welfare, civic improvement, pleasure, recreation or any other purpose except profit; and
- \* it does not distribute or otherwise make available for the personal benefit of a member or shareholder any of its income, unless the member or shareholder is an association which has as its primary purpose and function the promotion of amateur athletics in Canada.

If an organization does not meet one of the criteria listed above at any particular time, then the organization ceases to qualify for the exemption provided by this provision. Subsection 149(10) of the Act will apply at the time the organization ceases to be a 149(1)(1) entity and provides

that the organization's taxation year ended immediately before that time. It is important to note that subsection 149(10) only applies if the organization is a corporation.

If subsection 149(10) of the Act applies, a new taxation year begins for the organization and the organization is deemed not to have established a fiscal period before this time. Further, the organization is deemed to dispose of all of its assets immediately before the time the organization ceases to be a 149(1)(1) entity for fair market value and immediately reacquire them for the same amount. The result is that any gain that accrued on the assets during the time the organization qualified as a 149(1)(1) entity will generally be exempt from tax. However, paragraph 149(5) of the Act contains specific rules with respect to the property income earned by 149(1)(1) entities the main purpose of which was to provide dining, recreational or sporting facilities to their members. If subsection 149(5) applies to an organization, the organization will be taxable on all capital gains, other than capital gains resulting from the disposition of property used exclusively for or directly in the providing of the dining, sporting or recreational facilities to members.

For purposes of calculating taxable income for the organization's first taxable taxation year, the organization is deemed to have deducted under sections 20, 138 and 140 of the Act the maximum allowable amounts that could have been claimed or deducted as a reserve under those sections. As well, for purposes of sections 37, 65 to 66.4, 66.7, 111 and 126 of the Act, and subsections 127(5) to (26) and section 127.3 of the Act, the organization is deemed to be a new corporation, and its first taxation year begins at this time. This means, for example, that the organization cannot claim a loss carry-forward as allowed by section 111 of the Act that the corporation accrued during the time it was a 149(1)(1) entity.

2. What steps must be taken to change a 149(1)(1) entity from a tax-exempt state to a taxable state?

An organization that qualifies for the exemption from tax provided by paragraph 149(1)(1) automatically changes its

status when it ceases to meet the requirements of that paragraph. Moreover, unlike for a registered charity, for a 149(1)(1) entity there is no loss of registration (such entities do not register under the Act), no formal notification process that must be followed and no revocation tax.

3. For how many years can we assess?

We spoke with the Administrative Law Section in Income Tax Rulings, which is the group that deals with issues involving assessments and collections of outstanding taxes. They advised that since XXXXXXXXXXXX was likely never a 149(1)(1) entity, section 152 of the Act would apply. Paragraph 152(3.1)(b) of the Act provides the general rule which is that a reassessment can be issued within 3 years from when the return was filed. However, if an organization has made a misrepresentation on the return, then subparagraph 152(4)(a)(i) applies, in which case, it is open for the Crown to assess the taxpayer at any time, for any period of time.

If you wish to discuss the application of these subsections or obtain further information regarding this topic, please contact Mr. Lindsay Frank of our Administrative Law Section at 613-948-2227.

4. Does the decision in Edmonton Badminton Club Ltd. v. M.N.R., (T.A.B.) 55 DTC 252, apply to the facts of XXXXXXXXXXXX ?

We have reviewed this decision, in which the Tax Appeal Board rejected the Minister's reassessment of the taxpayer as a taxable organization. The Tax Appeal Board took the position that the Minister failed to produce facts in support of its reassessment.

In our view, this decision does not stand for the proposition that CRA is prevented from reassessing an organization on the basis that the organization's tax-exempt status was not challenged for several years. In other words, just because you were not reviewed for several years does not mean that CRA accepted that you were entitled to the exemption. To the extent it stands for anything, the decision reminds the CRA that clear evidence

must be presented to the court in support of a reassessment, especially if the taxpayer can generally show that the taxpayer qualified for the exemption claimed. To be clear, in our view, this decision does not prevent the CRA from reassessing XXXXXXXXXXXX as long as there is evidence that XXXXXXXXXXXX did not qualify for the exemption from tax in a particular year or years.

5. How does the application of subsection 149(10) affect the organization's limitation period?

Subsection 149(10) of the Act applies only to corporations and it applies at the time the corporation ceases to qualify for the exemption from tax provided by paragraph 149(1)(1) of the Act. Subsection 149(10) deems the corporation, which is now taxable, to be a new corporation for the purposes of filing future income tax returns and determining loss carry forward balances and reserves. All returns filed by the taxable corporation will be subject to the normal reassessment rules contained in the Act. We note that if XXXXXXXXXXXX never qualified for the exemption from tax provided by paragraph 149(1)(1), then subsection 149(10) does not apply.

6. Is CRA required to audit an organization claiming an exemption under paragraph 149(1)(1) of the Act each year?

The criteria of paragraph 149(1)(1) of the Act are such that the question of whether an organization qualifies for this exemption is generally considered at the end of each particular taxation year. This means that an organization relying on this exemption for a period of several years must prove that the organization met the criteria of paragraph 149(1)(1) throughout each year. The fact that the organization qualified in a previous year is irrelevant.

There is no requirement for the CRA to review an organization claiming an exemption from tax pursuant to paragraph 149(1)(1) of the Act either in its first year or in any subsequent year. We agree with you that when auditing an organization that has claimed the exemption under paragraph 149(1)(1) for several years, each year is examined separately to determine whether the organization

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qualified for the exemption based on the operations of the organization for that particular year.

We trust that these comments will be of assistance.

For your information 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 distributed to the commercial tax publishers for inclusion in their databases. The severing process will remove all material that is not subject to disclosure, including information that could disclose the identity of the taxpayer. Should your client request a copy of this memorandum, they can be provided with the electronic library version, or they may request a severed copy using the Privacy Act criteria, which does not remove client identity. You should make requests for this latter version to Mrs. Jackie Page at (819) 994-2898. A copy will be sent to you for delivery to the client.

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