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Prenez note que ce document, bien qu'exact au moment émis, peut ne pas représenter la position actuelle de l'ARC.

PRINCIPAL ISSUES: Can a cooperative housing corporation that participates in the XXXXXXXXXXXX qualify for the exemption provided by paragraph 149(1) (1) of the Act?

POSITION: No.

REASONS: The program requires that any surplus earned by the cooperative be returned to its occupants, which will include members.

July 28, 2011

Compliance Programs Branch
Specialty Audits Section
Attention: Rubin Dressler

HEADQUARTERS
Income Tax Rulings
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2011-039498

XXXXXXXXXX (the "Co-op")

We are writing in response to a request for our views as to whether the Co-op qualified for the tax exemption provided by paragraph 149(1) (1) of the Income Tax Act (the "Act") for the years under review. In particular, we were asked to consider whether the agreement the Co-op entered into with the Canada Mortgage and Housing Corporation ("CMHC"), which required the Co-op to establish certain reserve funds, prevented the Co-op from claiming this tax exemption.

FACTS

Based on the information provided to us by the auditor, which included the financial records of the Co-op, its incorporating documentation, the agreement between the Co-op and CMHC, and the application form for members, our understanding of the facts is as follows:

* The Co-op was incorporated without share capital under the XXXXXXXXXXXX , on XXXXXXXXXXXX .

* The objectives of the Co-op are:

o to provide residential accommodation of any class or kind on a cooperative basis to persons, the majority of whom will be members of the cooperative, who will occupy the housing otherwise than as owners;

o to construct, operate, maintain and improve, and to buy, own, sell, convey, assign, mortgage or lease any real estate and any personal property necessary or incidental to the provision of such housing;

o to enter into any kind of activity and to perform and carry out contracts of any kind necessary to or in conjunction with or incidental to the accomplishment of providing such housing;

o to become a member of associations or corporations having objects altogether or in part similar to those of the cooperative or carrying on any business activity capable of being conducted so as to directly or indirectly to benefit the cooperative; and

o to encourage and promote a better understanding of cooperative principles and to contribute to the betterment of the community at large.

* The articles of incorporation provide that:

o the cooperative shall be carried on without the purpose of gain for its members;

o any profits or other accretions to the cooperative shall be used for the purpose of promoting its objectives;

o upon dissolution of the cooperative and after payment of all debts and liabilities, its remaining property shall be distributed or disposed of to charitable organizations, carrying on their activities solely within Canada; and

o the directors shall serve without remuneration, and the directors shall not receive, directly or indirectly, any profit from their positions as directors, but may be paid reasonable expenses incurred by them in the performance of their duties.

* The membership fee is \$XXXXXXXXXX and is payable only once.

* Members contribute a loan of \$XXXXXXXXXX to the Co-op upon becoming a member.

* The loan is returned once a member vacates a dwelling unit and leaves the Co-op. The Co-op may not return the full amount of the loan to a member if the member owes amounts to the Co-op or the dwelling unit has been damaged.

* There is no specific clause in the articles of incorporation that prevents the Co-op from paying patronage or other dividends to its members.

* The Co-op signed an agreement with CMHC in XXXXXXXXXXXX (the "Agreement") to participate in the XXXXXXXXXXXX .

* Under the Agreement, the Co-op agreed to XXXXXXXXXXXX .

* The Agreement contains numerous definitions. Key definitions for our review include:

XXXXXXXXXX

* We also considered the following provisions of the Agreement:

XXXXXXXXXX

OUR COMMENTS

Overview

In general terms, paragraph 149(1)(1) of the Act provides that the taxable income of an organization 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 a club, society or association;

* 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

* its income is not available for the personal benefit of a member or shareholder, unless the member or shareholder is an association which has as its primary purpose and function the promotion of amateur athletics in Canada.

The Co-op is a corporation and does not appear to be a charity (although see comments below). In order to qualify for the exemption from tax contained in paragraph 149(1)(1) of the Act, the Co-op must be organized and operated exclusively for a purpose other than profit and its income cannot be available for the benefit of its members.

Profit Purpose

A review of the incorporating documents of the Co-op indicates that it is organized exclusively for a purpose other than profit. With respect to the operations of the Co-op, the Agreement requires the Co-op to set each year's rents on a cost-recovery basis (other than for the first year, which is not under review). Based on the facts provided, the Co-op offered housing to its members at as close to cost as possible for the years under review. We were not advised of any other activity that would

require our consideration. Thus, the Co-op appears to have been operating for a purpose other than profit.

Income to Members

The Co-op does not appear to satisfy the condition that no income be available for the personal benefit of members. Under subsection XXXXXXXXXXXX of the Agreement, the Co-op is required to return any "surplus of revenue" to its occupants, who clearly include its members. A corporation that can pay its surplus to members does not qualify for the tax exemption provided by paragraph 149(1)(1) of the Act. (This is the reason that cooperatives generally do not qualify for this exemption; however, as described below, different provisions of the Act may be of assistance to cooperatives.)

The Co-op is also required to maintain a XXXXXXXXXXXX fund under its Agreement with CMHC. It appears that the purpose of this fund is to help members of the Co-op who are having difficulty paying rent, but who do not qualify for rental assistance from the government, by providing them with financial support. The Agreement does not specifically state where the contributions to this fund should come from, but it does require the Co-op to make contributions to the fund. It appears that this fund would consist, at least in part, of income of the Co-op, and that allocating amounts from this fund to members to assist with rental payments would be allowing income of the Co-op to be available for the personal benefit of its members.

Patronage Dividends and Cooperative Corporations Under the Act

Housing cooperatives generally do not qualify for the tax exemption under paragraph 149(1)(1) of the Act, as cooperatives are usually required to make surplus available to members by way of allocations commonly referred to as patronage dividends. For example, consider the relevant provisions from the Co-operative Corporations Act of Ontario, R.S.O. 1990, c. C.35:

Subsection 55(1)

"... [T]he surplus arising from the business of a co-operative ... in each fiscal year shall be allocated, credited or paid to the members in proportion to the business done by each member with or through the co-operative..."

[Emphasis added.]

Subsection 55(3)

"The amount that is allocated, credited or paid in each fiscal year to members or non-members of a co-operative ... is known as the patronage return."

The Co-operative Corporations Act of Ontario also has a specific part providing rules for "Non-Profit Housing Co-Operatives". The key provisions for our purposes are as follows:

Subsection 171.2(1)

"A non-profit housing co-operative shall not distribute or pay any of its property to its members during its existence or on its dissolution."

Subsection 171.2(2)

"Despite subsection (1), a non-profit housing co-operative may pay a member,

(a) amounts owed to the member including patronage returns..."

In summary, under the Ontario cooperatives legislation, a cooperative is required to allocate its surplus to its members through patronage dividends. This rule applies even to non-profit housing cooperatives (as described in the legislation), notwithstanding a general rule against distributing the property of such cooperatives to members.

While housing cooperatives do not generally qualify for the tax exemption provided by paragraph 149(1)(1) of the Act, the Act does provide specific rules for cooperative corporations that are designed to take into account the specific legislative and operational framework of these corporations. Very generally, these rules allow a taxpayer, and in particular a "cooperative corporation" (as defined in subsection 136(2) of the Act), to reduce its taxable income by the amount of certain allocations (patronage dividends) paid out to members. Thus, while a housing cooperative may not be tax-exempt under paragraph 149(1)(1), it may not have any tax payable after applying the rules in sections 135 and 136 of the Act.

A cooperative corporation is defined in subsection 136(2) of the Act to mean, among other things, a corporation incorporated under federal or provincial law providing for the establishment of the corporation as a cooperative corporation for the purpose of performing services for its members or customers, if three conditions are also met. Briefly, these three conditions, in general terms, require that the prospect specifically be set out that payments will be made to the corporation's members and customers in proportion to patronage; that none of the members have more than one vote in the affairs of the corporation; and that at least 90% of the corporation's members be individuals, other cooperative corporations, or certain other entities. It would be a question of fact whether a particular housing cooperative was a cooperative corporation for purposes of the Act.

Generally, a patronage dividend that is received by a member of a cooperative corporation is included in his or her income for tax purposes under subsection 135(7) of the Act, however, there is an exception for allocations in respect of "consumer goods or services". "Consumer goods or services" are defined as

"goods or services the cost of which was not deductible by the taxpayer in computing the income from a business or property."

Although the tax treatment of a particular allocation is always a question of fact, it appears that allocations from a cooperative corporation that was a housing cooperative would usually be in respect of

"consumer goods or services", as the amounts paid by the members to the cooperative would relate to personal living expenses and would not be deductible in computing the members' income. Please see Interpretation Bulletin IT-362R, "Patronage Dividends", for more detailed comments regarding the payment and taxation of patronage dividends.

Low-Income Housing Organizations - Other Exemptions

During our review of this file, you also asked us to comment on whether paragraph 149(1)(1) of the Act would be available to low-income housing projects operated by a municipality either directly or through a separate municipal organization. As always, it is a question of fact whether any particular organization is exempt from tax pursuant to paragraph 149(1)(1). However, paragraphs 149(1)(c) and (d.5) of the Act would usually provide a comparable tax exemption for low-income housing projects operated by municipalities and municipal organizations, and these provisions impose fewer restrictions on earning and distributing profit. Paragraph 149(1)(c) exempts the income of Canadian municipalities, while paragraph 149(1)(d.5) provides an exemption for municipal corporations, commissions and associations if certain conditions are met.

Although paragraph 149(1)(d.5) of the Act imposes a restriction on where the income of the municipal organization is earned (generally, no more than 10% of the organization's income may be earned from activities carried on outside the geographic boundaries of the municipality or municipalities), this restriction may not be of concern to municipal housing organizations, and may be significantly less problematic than the conditions imposed by paragraph 149(1)(1) of the Act. In particular, a tax-exempt municipal organization is not precluded from having a profit purpose; this may allow more flexibility with respect to funding the organization.

We note that paragraph 149(1)(d.5) of the Act would not apply to an organization that is only funded, not owned, by a municipality, as there are municipal ownership requirements that must be met in order for that exemption to apply. Consequently, low-income housing organizations that are funded or partially funded by municipalities, but privately owned, will need to rely on other provisions of the Act in order to be exempt from tax.

Paragraph 149(1)(i) of the Act specifically provides an exemption for corporations "constituted exclusively for the purpose of providing low-cost housing accommodation for the aged". This provision does not specifically preclude a profit purpose, although it does require that income not be available for the personal benefit of proprietors, members and shareholders.

Also, a low-income housing organization may be a charity. As explained in Policy Statement CPS-020 for "Applicants that are Established to Relieve Poverty by Providing Rental Housing for Low-Income Tenants", the Charities Directorate has determined that, on the basis of the Act and the common law, certain low-income housing organizations may be

considered to be established for the purpose of relieving poverty and are eligible for registration. A registered charity is exempt from tax pursuant to paragraph 149(1)(f) of the Act. As a charity cannot qualify for the exemption provided by paragraph 149(1)(1) of the Act, a low-income housing organization that is a charity must generally be registered in order to be exempt from tax (assuming that one of the other provisions noted above does not apply).

CONCLUSION

As the Co-op was required to pay surplus and provide financial support to members, it did not qualify for the tax exemption provided by paragraph 149(1)(1) of the Act for the years under review. However, sections 135 and 136 of the Act provide specific rules for cooperative corporations that may apply to the Co-op, allowing it to reduce its taxable income (if any) through the payment of patronage dividends, although we have not reviewed this issue in detail. Unlike paragraph 149(1)(1), sections 135 and 136 do not preclude an organization from having a profit purpose, and there is no restriction regarding payments to members (although only the specified allocations are deductible).

Please do not hesitate to contact us if we may be of further assistance.

Yours truly,

Eliza Erskine

Manager

Non-Profit Organizations and Aboriginal Issues

Financial Sector and Exempt Entities Division

Income Tax Rulings Directorate

Legislative Policy and Regulatory Affairs Branch