

Tax-Exempt Status Preserved – Despite Sophisticated Operations

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By Gregory Richards

A significant income tax advantage – indeed, an exemption – awaits a corporation that can successfully prove it is a non-profit organization within the meaning of paragraph 149(1)(l) of the Income Tax Act (“ITA”). So when that non-profit status is challenged, the stakes are high and a defence can be essential for ensuring the continued operations of the organization.

Such a defence was successful in the recent decision of the Tax Court of Canada in BBM Canada (formerly BBM Bureau of Measurement) v. The Queen, 2008 TCC 341 (CanLII). WeirFoulds litigators Greg Richards and Nikiforos Iatrou, together with tax practitioner Keith Laushway, acted for BBM. The BBM decision highlights that, even though sophisticated activities are carried on within a non-profit entity, the entity may nevertheless be exempt from paying income tax by meeting various tests set out in the ITA.

BBM: Canada's Rating Agency

BBM, originally known as the Bureau of Broadcast Measurement, was established over 60 years ago as a non-share capital corporation set up to provide impartial and accurate audience measurement data to its members. Today, its voting members are comprised of Canadian television and radio broadcasters, advertising agencies and representative advertisers, and its non-voting members include universities and government agencies such as Statistics Canada. BBM's functional counterpart in the United States, A.C. Nielsen, is a for-profit company known for its “Nielsen ratings”. BBM has performed this ratings function across Canada since BBM's inception but, significantly, as a not-for-profit entity.

Broadcasters are willing to pay for BBM's audience measurement data in order to make program decisions and to show the depth and reach of their programming in order to sell advertising. Advertisers and advertising agencies have similar interests but use the information to help in the strategic purchase of advertising space. Each sector of the industry wants to know the size and type of audiences associated with broadcast programs. Industry players become members of BBM and pay their annual membership fees to obtain the data.

BBM sets its fees on an anticipated cost recovery basis according to annual budgets set for each upcoming year. In some years, however, surpluses are earned while in other years deficits are incurred. Surpluses are not distributed to the members but, rather, used to further BBM's purposes.

BBM Catches CRA's Attention

Audience measurement has always been a complex activity involving surveys and statistical analysis. But with the advent of modern electronic measurement tools, the activity has become increasingly sophisticated, capital-intensive and expensive.

In the tax year at issue, 1996, BBM employed approximately 300 persons and achieved an operating surplus of over \$2 million, with

income primarily derived from the fees of its members. The organization's accumulated surplus by that point was approaching \$7 million. BBM planned to invest these funds in new electronic measuring equipment in future years. But the operating surplus, and the fact that BBM had a "for-profit" subsidiary conducting custom survey work, attracted the attention of Canada Revenue Agency ("CRA").

Under paragraph 149(1)(l) of the ITA, a club, society or association that is not a charity is exempt from paying income tax if it is "...organized and operated exclusively...for any other purpose except profit...". CRA challenged BBM's not-for-profit status and assessed the company for income taxes approaching \$1 million. BBM objected to the assessment. CRA denied the objection and confirmed its assessment. BBM then filed a notice of appeal to the Tax Court of Canada. The fight was on.

The Trial of the Appeal

The case was heard by the Honourable Justice Patrick Boyle of the Tax Court of Canada. In order to win the case, BBM had to establish that it was both organized and operated exclusively for a purpose other than profit. It submitted evidence concerning the manner in which BBM was established (letters patent, by-laws and the like) as well as evidence concerning the details of its day-to-day operations.

The Crown argued that an organization cannot be considered to be organized and operated exclusively for a purpose other than profit if the establishment or operations of the entity are related to the commercial or business activity of its members or of others. The thrust of the Crown's case was that BBM failed to meet the requirements of the ITA because its purpose was to provide audience measurement data to members that include industry giants such as CBC, CTV and Global, and the data assisted the members in furthering their commercial and business activities.

The Crown also cited CRA's Interpretation Bulletin (IT-496) that points to several "badges" of a profit-oriented enterprise, including the realization of profits, the accumulation of reserves, the entity operating in a normal commercial manner, goods and services being sold to non-members and the entity's operations being in competition with taxable entities.

The court rejected the Crown's arguments and found it was legitimate for non-profit entities to operate in a business-like manner and to avoid waste and capture efficiencies without becoming a for-profit organization. Justice Boyle made note of a number of multi-million dollar organizations, including the Canadian Bar Insurance Association, the Canadian Medical Protective Association and the Real Estate Boards of major urban centres, that are run as not-for-profits.

In the end, Justice Boyle's analysis came down to this key point:

"The operations of not-for-profit entities like BBM lack a significant attribute of commercial businesses. There is no opportunity for their shareholders, members or controlling persons to benefit financially by way of profits, distributions, unrestricted salaries, capital appreciation of the undertaking or its assets, or in similar fashion."

Justice Boyle allowed BBM's appeal with costs. The Crown did not appeal and BBM's tax-exempt status was preserved.

Sophistication – but not taxation

The BBM case shows that highly sophisticated activities may be conducted within an entity that is run on a not-for-profit basis without jeopardizing the entity's tax-exempt status. This allows a non-profit entity to devote all its revenue, net of costs, to its not-for-profit goals and objectives. The BBM decision helps to preserve this significant tax benefit for those using the not-for-profit model.

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