

INTERPRETATION BULLETIN #2

POLICY STATEMENT NON-PROFIT AND RELATED BUSINESSES

Purpose

The following guidelines provide clarity and direction to HRM staff and customers with respect to the eligibility of a business entity, or business-related operation, owned by or operated in association with a not for profit or non-profit organization¹ and municipal assistance programs. This policy does not, however, constitute an entitlement. Any assistance provided by HRM is discretionary and certain types of non-profit organization, or specific programs and services, remain ineligible. All applicants shall be evaluated relative to the respective program's policies and procedures approved by Regional Council.

Introduction

Given that a variety of concessions are awarded to organizations on the basis of "non-profit status" it is important to evaluate the exact nature of their operations. Some groups might have the appearance of a non-profit (ie. an annual registration) but do not conduct themselves as such. The term "non-profit" does not denote a lack of revenue or an inability to generate revenue; it **means** that all proceeds are re-invested back into the organization to further its' primary altruistic aims. Typically, operations are directed exclusively or predominantly by volunteers. Within this context, a business that is simply not profitable (breaks even or incurs a loss) is not a non-profit.

Presently, there are **three common ways to register a non-profit**:

- Society under the Societies Act (R.S.1989);
- Non-profit cooperative under the Cooperative Associations Act (R.S. 1989); and
- Non-profit corporation incorporated under the Companies Act (R.S. 1989).

In a few cases an organization may be incorporated under a special Act of the Nova Scotia Legislature; this policy shall apply equally to such non-profit entities.

A non-profit business, partnership, or sole proprietorship does not exist, but a legally existing non-profit might register a separate legal business entity.

Examples:

- *A non-profit housing cooperative registers a separate business that operates as a*

¹ For the purpose of this policy the terms not for profit and non-profit are regarded as synonymous; the term non-profit is used throughout for clarity.

building management company

- *A non-profit society serving persons with a disability registers a separate business that operates a manufacturing company that employs disabled clients*
- *A non-profit society registers a separate business to operate a retail store*

The Municipal Government Act (1998) does not permit a less than market value sale or lease, or property tax exemption, to an industry, trade, or business. **This means that the sale or lease price must be market value if the tenant or purchaser is a sole proprietorship, business, commercial enterprise, or industry.**

Section 51 of the Municipal Government Act (1998) does however, permit the sale or lease of property at a price which is less than market value to a non-profit organization that it considers to be carrying on an activity that is beneficial to the municipality.

Where a business is a separate entity wholly owned and operated by a non-profit society, eligibility should be evaluated on a case-by-case basis. **After consideration of all the facts, an assessment will be made to determine whether the business is an acceptable or related business or an unacceptable business or an unrelated business.**

Essentially, a non-profit is distinguished from a for-profit by the fact that any revenues/profits are retained by the society and are not distributed among the membership, Board of Directors or Executive Officers. Should the organization cease operations any residual monetary or material assets are donated to another non-profit with similar aims. The Board of Directors of a society are not employees and are not paid (albeit they may receive incidental expenses such as parking, travel, meals etc).

The following guidelines are derived primarily from Canada Revenue Agency's policies developed for the federal Charities Directorate. These federal policies and their interpretation help distinguish between an "acceptable" related business activity to be recognized as non-profit. The following guidelines are provided to help HRM staff evaluate a request for a less than market value property lease or sale, property tax exemption, or grant requested by a non-profit society, charity, or non-profit cooperative who may operate a business such as, but not limited to retail or manufacturing services. **These guidelines also include reference to contractual relationships between a non-profit and a business such as, but not limited to profit-sharing arrangements.**

Some activities are intended to generate profit but are not considered to be businesses:

Soliciting Donations

Soliciting donations of money or goods is not considered a business because the *donor does not expect to receive goods or a service, or, one of comparable value*. A 'token' of appreciation may be given to the donor such as a decal, t-shirt, or card. Incentives to donors might include public recognition, naming (a scholarship, trust fund, award, trophy, a building), or in the case

of charities a receipt for income tax deductions.

Note: charitable tax receipts are not issued for membership fees. So, if a person buys an annual membership costing \$10 and makes a payment of \$70 any tax receipt can only be issued for the value of the donation ie. \$60.

Selling Donated Goods

Selling donated goods is not considered a business because businesses do not depend on donated goods to create their inventories and the non-profit or charity conducting the sale does not assume any risk associated with the production or initial purchase of the goods. For example: sale of used clothing, flea market, bake sale, silent auction, equipment lending service, or bottle drive.

Exception: if donated goods are processed into 'new' goods the activity might be considered a business activity.

Fees Charged for Charitable Programs

Fees charged for a program or service do not necessarily indicate a business activity if they are altruistic and provide public benefit. This includes some forms of community economic development activity such as training in vocational and life skills and "social businesses" such as those that serve the needs of persons with disabilities.

Other examples of fees that might not be considered a business activity include admission fees to a museum or public gallery or rent paid to a non-profit housing cooperative. The following are some of the indicators that a charitable program involving a fee is not a business:

- . fees are used to defray all or a portion of program expenses rather than to generate a profit
- . the program does not offer services comparable to those available in the open market
- . fees are set according to a charitable objective not in competition with the market (eg. a sliding scale of fees based on an inability to pay, or to promote broad public participation such as free admission).

Fund-raising Events.

The primary purpose of a fund-raising event is to raise money to be used for a charitable or non-profit purpose; holding the event is not an aim in itself. The cost of such events are decreased by the use of volunteers and many supplies may be donated. *The event is not a continuous operation and thereby not a source of employment or an occupation.* The frequency of the event does not amount to conducting a regular business.

Example:

A non-profit society's aims of incorporation are to promote the development of jazz music. One of the society's activities is to host an annual jazz festival. The event is organized and delivered by the society's paid staff and/or volunteer members and subordinate to the society's altruistic aims. In effect, the event is an integral aspect of the society's on-going programming or a non-recurring special event. If the society ceased operations the event would not occur.

Investment Income.

Some non-profit groups and charities derive revenue from interest earned on investments. This is not considered a business activity if the primary risk is in the purchase and not trading and does not involve the organization holding the investment in the business operations of the entity issuing the shares, stocks, securities etc. The organization is essentially "passive" and prudent; thereby diminishing potential profitability as compared to speculative trading. Most non-profit organizations and charities tend to use secure, low-risk means of earning interest such as bank savings accounts, government guaranteed bonds or certificates (eg. T-bills, GIC's), mutual funds etc.

There are two kinds of related businesses:

Businesses that are run substantially by volunteers

A business is not considered for-profit if the enterprise is run substantially by volunteers ie. at least 90% of the labour is provided by unpaid volunteers (an employee would include contract personnel).

In some cases 'employees' might be paid a stipend and in most circumstances this would not be considered equivalent to a salary or wage. If, for example, the stipend was a form of 'flow through' and was provided by Nova Scotia Community Services towards employment for persons with special needs, a work placement opportunity for a student or new immigrant, or a return to work initiative for an older adult.

Businesses that are linked to a charity's purpose and are subordinate to that purpose

Linked

The fact that the profits from a business are applied to a charitable purpose is not sufficient to constitute the necessary linkage. Instead, it is the nature of the business, and whether it is a related business. A business will be considered linked to a charity's purpose if it fits within one of the following categories:

- . **business activities that supplement charitable programs and are either necessary for the effective operation of the program or improve the quality of the service delivered ie. a hospital parking lot; a gift shop in an art gallery;**
- . **off shoot - a charity creates an asset that it can exploit in a business. The charity**

carries out its charitable program, not in order to create the asset, but to achieve its charitable purpose. The asset is a by-product of the charity's program ie. selling grain grown at a heritage village or tapes of a church service;

- . use of excessive capacity - this type of business involves using a charity's assets and/or staff during periods when they are not being used to their full capacity within one of the charitable programs ie. renting out rooms in a student facility during the summer; or a church renting out its parking spots during the week;

In the above examples, the charity acquired the asset in question because it was needed in its charitable programs and because it made economic sense to acquire the asset rather than to lease it. These conditions need to be met for the business use of the asset to be considered a related business.

- . sales intended to advertise, promote, or symbolize the charity or its objects ie. pens, t-shirts or posters depicting the work of the charity

Subordinate

A business is subordinate to a charity's purpose if it remains subservient to a dominant charitable purpose, as opposed to becoming a non-charitable purpose in its own right. Factors which are taken into consideration in assessing whether a business is subordinate include:

- . amount of attention and resources received relative to the charity's operations as a whole
- . extent to which the commercial activity is a stand alone operation
- . extent to which the organization's charitable goals continue to dominate its decision-making
- . does the organization continue to operate for an exclusively charitable purposes?

The nature of the business activity is not the society's reason for being or their primary mandate. A society's business enterprise might support the society, but the society does not support the business. The aim of this distinction is to discourage a for-profit business activity fronting as a non-profit society. In effect, if the business closed the society would continue, but if the society closed, the business activity would cease because it is subordinate to the society.

Sub-Contracting a Program or Service to a For-Profit Entity.

A tenant leasing a property from HRM might sub-contract the provision of a specific program or service to a for-profit entity. In such cases, HRM as owner of the property should evaluate the rental rate and property tax status.

Examples:

A non-profit society leases a building from HRM and sub-lets an office to a self-employed writer. The sub-tenant is a private interest and therefore should pay market value rent and a proportional share of Commercial tax. Whether or not the person “makes a living” or generates a profit from their work is not relevant; they are not considered a non-profit.

*A non-profit society sub-contracts the operation of a bar to a sole proprietor (this is a licensed premises not simply an occasional liquor license). The society and the business share the profits 50/50. Because there is a personal financial gain by a business interest that is a separate entity from the non-profit (ie. **is not linked to and is not subordinate to the society’s altruistic aims**) this would be considered a business and liable for Commercial property tax, market value rent, or market value sale.*

The rent for this particular space should be at market value and the property tax full Commercial. The operator is a for-profit entity (even if the sub-contractor actually loses money on the deal) and generates revenue from the operation. Note: this is a different scenario from a non-profit tenant receiving approval for an occasional license for a non-recurring special event.

Societies: Directors as Employees

Staff may need to confirm the nature of the relationship between members of the Board and receipt of payment and/or possible conflict of interest. For example, The Board of Directors of some smaller societies might have members who are also paid performers or instructors, or a Board might comprise tenants who issue service contracts or set rental rates.

A Non-Profit Society or Charity Serving Business Aims

Two or more related, or unrelated, businesses might form a registered society or charity for the purpose of advancing professional, business or industry aims. Such a non-profit would not be recognized by HRM for a grant, property tax exemption, or less than market value lease because the society is subordinate to the (various) business interests.

Examples:

- **A charity formed to advance the tourism industry whose membership comprises self-employed persons, small business, government agencies, and corporations. In this case if the non-profit ceased to exist the individual and business interests would continue independently.**
- **Various wine producers, distributors and retailers collaborate in organizing an annual wine festival. The event would not be eligible for funding because it serves business,**

commercial enterprise or industry².

Case Evaluation

In some complex cases it may be necessary to check a society's incorporation documentation (constitution, by-laws, financial statements, reporting to Revenue Canada or the Registry of Joint Stocks), and seek advice from HRM Legal Services, the Nova Scotia Registry of Joint Stocks, or Revenue Canada.

² The only exception might be if the event were eligible for funding from the Hotel Marketing Levy which is a supplementary tax levied on the local hospitality industry or by a municipally recognized business development association funded through a supplementary tax.