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CRA Policy Statement

What is a Related Business?

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CPS - 019

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Purpose

This policy statement outlines the Directorate's policy for determining whether an applicant organization or an existing registered charity is carrying on an acceptable business (a "related" one) or an unacceptable business (an "unrelated" one).

Statement

There are two kinds of related businesses:

- a. businesses that are run substantially by volunteers; and
- b. businesses that are linked to a charity's purpose and subordinate to that purpose.

Implementation

1. This policy applies to applicant organizations and registered charities that carry on a business.
2. The *Income Tax Act* says that charities can lose their registration if they carry on an unrelated business.[\[Footnote 1\]](#) By implication, the law allows them to carry on a related business. Charities designated as private foundations are an exception—they can lose their registration if they carry on any kind of business, whether related or unrelated.[\[Footnote 2\]](#) The *Income Tax Act* does not define a related or unrelated business, apart from saying that a volunteer-run business is to be considered a related business, even if there is no link between the business and the objects of the charity.[\[Footnote 3\]](#)
3. Charity law, reinforced by provisions in the *Income Tax Act*, [\[Footnote 4\]](#) requires that charities have exclusively charitable purposes. Running a business cannot become a purpose in its own right—it must remain subordinated to the organization's charitable purpose.

A. What is a "business"?

4. In general terms, a business involves commercial activity—deriving revenues from providing goods or services—undertaken with the intention to earn profit.

Whether a particular activity of a charity is a business requires the facts and circumstances in each case to be considered in the light of certain criteria established by the courts:[\[Footnote 5\]](#)

- *The intended course of action* - If the rationale for operating a given activity is to generate a profit, then the activity is likely a business.
- *The potential to show a profit* - Even if an activity does not yield a profit, it may nonetheless be capable of earning a profit. In determining whether a particular activity is a business, it is the intention and capacity to make a profit at some point that are relevant. On the other hand, if the activity is structured so that it is incapable of returning a profit, then it is not a business.
- *The existence of profits in past years* - When the activity has been carried on for some time, a history of it returning a profit would generally imply that a business exists.
- *The expertise and experience of the person or organization that undertakes the activity* - If the person or organization that is undertaking the activity has been selected for the position because of his/her/its commercial knowledge, skill, or experience, it may indicate that the activity is commercial in nature and so may be a business.

5. Some activities are intended to generate a profit but are **not** considered to be businesses:

- *Soliciting donations* - This is not considered to be a commercial activity because donors do not expect any good or service in return for their contributions. Since the activity is not commercial, it is not considered to be a business.

- *Selling donated goods* - This is not considered to be a commercial activity because businesses do not depend on donations to create their inventories. Further, in selling off donated items, the charity does not assume the costs or level of risk usually associated with running a business. Rather, it merely seeks to convert a donated asset into cash.[\[Footnote 6\]](#)

6. Fees are charged in the context of many charitable programs. The presence of fees does not necessarily mean that a program is non-charitable[\[Footnote 7\]](#) or that the charity is engaging in a business activity. Programs remain charitable as long as they manifest the two essential characteristics of charity—altruism and public benefit.[\[Footnote 8\]](#) They can cease to be charitable programs and become businesses if these elements are lost.

- Examples of fees earned in the context of charitable programs include rent in low-income housing programs, university tuition fees, and museum admission. Other examples of fully acceptable charitable programs are identified in *Registered Charities: Community Economic Development Programs*. They include micro-enterprise programs, "training businesses" (which provide on-the-job training in vocational and life skills), and "social businesses" (which address the needs of people with disabilities).

7. The following are some of the indicators that a charitable program involving a fee is **not** a business:

- The fee structure is designed to defray the costs of the program rather than to generate a profit.
 - However, when a government pays a charity to provide a program to the public on the government's behalf, this revenue also needs to be considered, in addition to any fees paid by the public, when determining whether the intention of the program is to generate a profit.
- The program does not offer services comparable to those otherwise available in the marketplace.
- The fees are set according to a charitable objective as opposed to a market objective. For example, they are designed to relieve poverty by being set in accordance with the users' means, or to promote broad public participation in an educational program, such as waiving admission charges to an art exhibit.

8. Expenditures on a charitable program can be used to satisfy the disbursement quota, but not expenditures on a business.

B. What is "carrying on" a business?

9. "Carrying on" a business implies that the commercial activity is a continuous or regular operation.

10. A charity can engage in some business-like transactions, provided they are not operated regularly or continuously. Case law does not provide clear guidance in this area, although the distinction is clear enough at the extremes. On the one hand, a one-time sponsorship deal would not generally be considered to represent the "carrying on" of a business. On the other hand, making sales or providing services on a regular daily or even weekly basis, with the operation requiring ongoing care and attention, would likely be viewed as "carrying on" a business.

11. Most **fundraising events** are business activities. They typically involve the sale of goods and services for the purpose of obtaining income. For example, a person makes a payment to a charity and receives in return a ticket of admission to a concert. The primary purpose of a fundraising event is to raise funds, and holding the event is not an end in itself. Thus, a substantial percentage of the gross revenue from the event is actually applied for a charitable purpose. Often the costs of the event are held down because volunteers provide a significant component of the labour and many of the supplies are donated. An event conducted as a business would not have a comparable element of support for charity. A fundraising event also typically attracts a clientele who are aware the profits from the event will be applied for a charitable purpose and who generally wish to support that purpose.

12. Yet even if fundraising events are business activities, in practice they are mostly not affected by the related business provisions because they do not amount to "carrying on" a business. In locating the dividing line between a fundraising event and carrying on a business, the following factors come into play:

- A fundraising event has clear "start" and "end" points. In contrast, carrying on a business implies continuous operations.
- A fundraising event of a particular type does not recur with such regularity and frequency that it amounts to carrying on a business.

13. Some charities hold several fundraising events during the course of the year. These events may be quite distinct in nature, such as a charity auction, a golf tournament, a ball, and a telethon. Each event would then have to be evaluated on its own merits to determine whether it amounted to carrying on a business. Or a charity may be repeatedly holding the same event (or very similar events), such as a draw held on a monthly or weekly basis. The more similar the events are, the more likely they are to be evaluated as a group to determine whether they amount to carrying on a business.

14. Deriving income from **investments** can also be different from carrying on a business. Distinguishing between the two is a question of fact. In a sense, both businesses and investments depend on the use of assets. The type of asset is not always a reliable guide—while there are many kinds of assets more typically associated with investments, such as common or preferred shares and bonds, there are other assets, such as real estate and royalty interests, that may equally well be used by investors and businesses. However, income from investments does share a number of characteristics:

- Investment income is derived primarily from the mere ownership of the asset. It is not dependent on active trading such as conducted by dealers who buy an asset in order to sell it as soon as possible at a profit, or the exploitation of the asset such as conducted by manufacturers or resource companies.
- With investment income, the risk to the charity is generally limited to the purchase price of the asset.
- Deriving investment income is also fundamentally a passive activity, in that it does not call upon the charity to take any active role in operating the underlying business.

15. Charities need to invest their capital and any funds not required for their current operations. Charity law dictates that a charity's assets be managed so as to obtain the best return within the bounds of prudent investment principles. As long as a charity manages its investments prudently, this function would generally be regarded as a necessary administrative function and not a business activity. [\[Footnote 9\]](#)

16. **Partnerships** form an exception to the description of investments as providing passively earned income. A charity that becomes a limited partner in a partnership is carrying on a business and is not simply making an investment, even though the charity plays no active role in the business. This position is based on the laws governing partnerships. [\[Footnote 10\]](#)

C. What is a related business?

17. There are two kinds of related businesses:

- a. businesses that are run substantially by volunteers, and
- b. businesses that are linked to a charity's purpose and subordinate to that purpose.

a. Businesses run by volunteers

18. The *Income Tax Act* defines related businesses as including those businesses that are not related to the charity's objects but which have substantially all those employed in the business serving as unpaid volunteers. [\[Footnote 11\]](#) As a rule-of-thumb, "substantially all" means 90%.

19. The people "employed" in the business means the people the charity "uses" to operate the business. It includes those working for the charity under contract as well as the charity's direct employees.

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

Linked

20. The fact that the profits from a business are applied to a charitable purpose is not sufficient to constitute the necessary linkage. [\[Footnote 12\]](#) (Charities are required to apply their resources to charitable purposes, whether or not they are carrying on a business.) Instead, it is the nature of the

business, and whether it has some direct connection to a charity's purpose, that determines whether it is a related business.[\[Footnote 13\]](#)

21. Four forms of connection or linkage have been identified. A business will be considered linked to a charity's purpose if it fits within one of the following categories:

(i) A usual and necessary concomitant of charitable programs

22. These are business activities that supplement charitable programs. Either they are necessary for the effective operation of the programs, or they improve the quality of the service delivered in these programs.

23. Examples include:

- a hospital's parking lots, cafeterias, and gift shops for the use of patients, visitors, and staff;
- gift shops and food outlets in art galleries or museums for the use of visitors; and
- book stores, student residences, and dining halls at universities for the use of students and faculty.

(ii) An off-shoot of a charitable program

24. In the ordinary conduct of its charitable programs, a charity may create an asset that it can exploit in a business. The charity carries out its charitable programs, not in order to create the asset, but to achieve its charitable purpose. The asset is simply a by-product of the charity's programs.

25. Examples include:

- A heritage village plants various grain crops in the fields surrounding the village. It does this so it can show visitors 19th century farm implements and how these implements were actually used. The grain is taken by cart to the village's mill, where visitors can watch it being ground into flour. This flour is then sold in a store within the heritage village and in a for-profit grocery store in a nearby community. The charity is engaging in a related business when it sells the flour to visitors and to the grocer for re-sale. The business is a related one because what is being sold was produced in the course of operating the charity's educational programs.
- A church records its regular Sunday services for the benefit of members of the congregation who may have missed the service and others who wish to listen to it again. The church charges a small fee to cover the recording cost. This activity is part of its charitable program of ministering to its congregation and is not a business activity. The same church has a famous choir, and each year its special Christmas services attract an overflowing attendance and a large audience for the recording of these services. The church sells the Christmas recordings, charging as high a price as it can obtain for them. This is a business activity. However, the business is related to the charity's purpose because the church first has to carry out part of its charitable program—holding the Christmas services—before it has anything to market.

(iii) A use of excess capacity

26. This type of business activity involves using a charity's assets and staff, which are currently needed to conduct a charitable program, to gain income during periods when they are not being used to their full capacity within the charitable program.

27. Examples include:

- A charity's program is a two-week arts festival held outdoors in July. The charity must have tents to protect performers and exhibits from the weather. No suitable tents are available in the community for rent, so the charity decides to buy its own tents. During the rest of the year, the charity can rent out the tents as a related business.
- During the academic year, a university needs classrooms and student residences to operate. However, during the summer months, they sit empty. The university can rent out its facilities to conferences or visitors as a related business.
- A church has a parking lot of a size determined by municipal by-laws or by the needs of its Sunday-morning congregation. It can rent out its parking spaces during the week as a related business.

28. 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.

29. If a charity has assets that it previously used to operate a charitable program, but which it no longer uses and is unlikely to use in the future, exploiting these assets as a business would not in principle be a related business. However, this is an area where fact-patterns are likely to vary and a variety of considerations may apply. For example:

- The market for the item may be temporarily depressed, so that it would be prudent for the directors to retain the asset until the market improves.
- The asset in question is not one that the charity can readily dispose of—for instance, a floor in a hospital building that the hospital closes as a result of funding cutbacks.

(iv) The sale of items that promote the charity or its objects

30. This type of business activity is linked to a charity's purpose because it involves sales that are intended to advertise, promote, or symbolize the charity or its objects. A product may serve this promotional purpose by virtue of its design, packaging, or included materials. Usually, the items are bought by those who want to contribute to the work of the charity, and they do not compete directly with products produced and sold by for-profit entities. Examples include pens, credit cards, and cookies clearly displaying the charity's name or logo, and T-shirts or posters depicting the work of the charity.

Subordinate

31. 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. This requires looking at the business activities in the context of the charity's operations as a whole.

32. In considering whether a business remains subordinate to a charity's purpose, four factors need to be considered. No one factor is likely to be decisive; nor is any single piece of evidence in support of a factor likely to be determinative. Rather, the various factors and the strength of the evidence supporting each of them need to be weighed together. The four factors indicating that a business is probably subordinate, and the types of evidence that could be relevant, are as follows:

(i) Relative to the charity's operations as a whole, the business activity receives a minor portion of the charity's attention and resources

33. What subjects dominate board meetings? How do managers allocate their time? In terms of expenditures, staffing, and assets such as buildings and vehicles, what proportion is applied to the business activity? If equipment or other resources are shared between charitable programs and business activities, how often are they used by the business?

34. If the amount of attention given to the business is high in a particular year, is this an anomaly occasioned by unusual circumstances, such as the year coinciding with the planning phase before the launch of the business?

(ii) The business is integrated into the charity's operations, rather than acting as a self-contained unit

35. To what extent is the commercial activity a stand-alone operation? In terms of its staffing, equipment, and physical location, how much is shared with the rest of the charity's operations? In its advertising, does the business make any reference to the charity and its purposes and programs?

36. Could the business operate as easily outside the charity as within it? Is it of comparable size to for-profit companies providing similar goods and services? Are the goods and services it provides indistinguishable from those offered by for-profit companies?

(iii) The organization's charitable goals continue to dominate its decision-making

37. Has the charity risked the assets intended for charitable programs to support the commercial activity? For example, has it borrowed against resources used in its programs to finance the commercial activity?

38. Are decisions being made on a bottom-line basis without regard to the organization's charitable purpose? For example, is an art gallery stocking items in its souvenir shop on the grounds of what sells best and ignoring the charity's mission to promote artistic excellence? Has consideration been given to a potential adverse impact on the charity's reputation from its commercial operations? Conversely, is there any evidence that the organization has rejected certain commercial activities because these were seen as inconsistent with its charitable purpose?

39. Who gets first call on the profits from the commercial operations—the charity's program areas or the business? What percentage of the gross commercial revenue is actually applied to charitable purposes? How much delay is there in applying business revenues to charitable purposes?

40. Over time, have the charity's programs changed direction because of decisions made for the benefit of the business activity? Has there been a drop in the services provided by the charity or their quality, accompanied by an increase in business activity?

41. How decisive a role do the managers of the business operation play in directing and managing the charity as a whole?

(iv) The organization continues to operate for an exclusively charitable purpose by, among other things, permitting no element of private benefit to enter in its operations

42. How many salaried employees does the commercial operation have? Are the salaries much higher than those for equivalent positions elsewhere? How much gross revenue is left after salaries are paid to the principals?

43. Does the business activity involve the participation of for-profit firms? Did the initiative to set up the business activity come from inside or outside the charity? Are the for-profit firms at arm's length with the charity? Did the charity obtain independent expert advice before committing to the relationship? Is the relationship between the parties fair?

D. Treatment of charities with unrelated businesses

44. Figure 1 below is a decision-tree for determining whether an unrelated business is present. It shows how the preceding paragraphs relate to each other.

45. If an organization applying for registration is operating an unrelated business, its application will be denied. If a charity already registered is operating an unrelated business, it is in breach of the law and could have its registration revoked.

46. However, before proceeding to revocation, a charity should normally be invited to wind-up the unrelated business or to place it in a separate taxable corporation. The charity would be expected to rectify the situation within a reasonable timeframe. If it does not do so, and there are no extenuating circumstances, its registration should be revoked.

47. If the charity establishes a separate taxable corporation, it can invest in the corporation on the same basis that it can invest in any other for-profit business. The charity's directors/trustees would need to satisfy themselves that the investment represents a prudent use of the charity's assets. They also need to be alert to ensure no benefit of a private nature is conferred on the corporation.

48. As long as its own governing documents and provincial legislation allow it to do so, [Footnote 14](#) the charity (if it is a charitable organization) can retain control over the taxable corporation through share holdings or a power to nominate the board of directors. However, the *Income Tax Act* does not allow a charity that is a foundation to acquire more than half of the voting shares of a taxable corporation, unless the shares are donated to the foundation. [Footnote 15](#)

Figure 1

Decision-tree for identifying an unrelated business

I. Is a particular activity a business carried on by the charity?

- Is the activity commercial in nature—that is, does the charity derive revenue in consideration for the provision of goods or services?
- Does the charity intend to profit from the activity?

Notes:

- A history of profits suggests an intention to profit. However, this intention may still be present even if there are currently no profits.
- The mere presence of a fee charged to users of a charitable program does not confirm an intention to profit.

If *no* to either question: the activity is not a business.

If *yes* to both questions:

- Is the income-earning activity simply the sale of donated goods?

If *yes*: the income-earning activity is not a business.

If *no*:

- Is the income-earning activity carried out on a systematic, regular basis?

If *no*: the income-earning activity is not the carrying on of a business.

If *yes*: the income-earning activity is the carrying on of a business.

II. Is the business of a charity an unrelated business?

- Are substantially all the people running the business volunteers?

If *yes*: the charity is carrying on a **related** business.

If *no*:

- Are the business activities linked to the charity's purpose?

If *no*: the charity is carrying on an **unrelated** business.

If *yes*:

- Are the business activities subordinate to a dominant charitable purpose?

If *no*: the charity is carrying on an **unrelated** business.

If *yes*: the charity is carrying on a **related** business.

Footnotes

[Footnote 1]

Paragraph 149.1(2)(a) for charities designated as charitable organizations, and paragraph 149.1(3)(a) for charities designated as public foundations.

[Footnote 2]

Paragraph 149.1(4)(a).

[Footnote 3]

Subsection 149.1(1) "related business."

[Footnote 4]

See the definitions of charitable organization and public foundation in subsection 149.1(1). Note also that various non-profit incorporating statutes, such as the B.C. *Society Act*, state that an organization cannot be incorporated under them for the purpose of carrying on a business.

[Footnote 5]

See, for example, *Stewart v. Canada*, 2002 SCC 46.

[Footnote 6]

Earth Fund v. Canada (MNR), 2002 FCA 498. However, sometimes charities handle the donated goods to such an extent that more than a straight conversion of goods to cash is involved. For example, a charity that receives donations of used clothing would be conducting a business if it cut up the articles and re-manufactured them to create "new" items for sale.

[Footnote 7]

See, for example, *Re Cottam's Will Trusts*, [1955] 3 All E.R. 704, at 705: "The fact that persons have to pay something under a trust of a charitable nature does not necessarily render that trust one that is not charitable ..." See also *Everywoman's Health Centre Society v. MNR* (1992) DTC 6001: "The Society is to be carried on an exclusively charitable basis with no intention to make a profit. ... Any surplus or charitable donations are to be used to reduce charges to patients."

[Footnote 8]

"Two central principles have long been embedded in the case law. ... These two principles, namely, (1) voluntariness (or what I shall refer to as altruism, that is, giving to third parties without receiving anything in return other than the pleasure of giving); and (2) public welfare or benefit in an objectively measurable sense, underlie the existing categories of charitable purposes, and should be the touchstones guiding their further development." *Vancouver Society of Immigrant and Visible Minority Women v. M.N.R.*, [1999] 1 S.C.R. 10.

[Footnote 9]

For more on this subject, see CPC - 023.

[Footnote 10]

Under the laws governing partnerships, the partner carrying on the business (the "general partner") is generally treated as the agent of the partner providing the financing (the "limited partner").

[Footnote 11]

Subsection 149.1(1) "related business."

[Footnote 12]

Earth Fund, supra:

[30] I do not accept the argument of counsel for the appellant that the *Alberta Institute* case is authority for the proposition that any business is a "related business" of a charitable foundation if all of the profits of the business are dedicated to the foundation's charitable objects. The Minister in that case was arguing that Alberta Institute was "a wholesaler of goods", but in fact Alberta Institute was simply soliciting donations of goods which it converted to money. This is somewhat different from the traditional fundraising activities of a foundation, but the difference is only a matter of degree.

[31] By contrast, the appellant proposes to do nothing except market and sell lottery tickets in a manifestly commercial arrangement that will, if all goes as planned, result in a profit that will be donated, I assume, to qualified donees. The appellant is in exactly the same position as any commercial enterprise that commits itself to apply its profits to charitable causes. Such a commitment, by itself, does not derogate from the commercial nature of the activity that generates the profit. Given the particular facts of this case, the Minister was justified in concluding that the appellant's proposed lottery operation would be a business of the appellant that is not a "related business", and thus would not qualify as a charitable activity

[Footnote 13]

Parallel foundations are set up to support a registered charity (for example, a hospital foundation that supports a particular hospital). In the case of a parallel foundation, the charitable purposes to which the related business can be linked include the purposes of the registered charity it supports. Thus a hospital foundation can operate any business that would be a related one if the hospital were to operate the business itself. See CPC - 002.

[Footnote 14]

This option does not appear to be open to Ontario charities, in that the province's *Charitable Gifts Act* does not allow them to retain control over a business.

[Footnote 15]

Paragraph 149.1(3)(c).