

Sales and Property Tax Exemptions for Charities*

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Although the *Income Tax Act* makes concessions to registered charities there is a surprising lack of specific sales- and property-tax exemptions for charities. This paper will attempt to outline some of the exemptions from federal sales tax, Ontario retail sales tax, and municipal taxes which *are* available to charities and will also comment on some of the shortfalls in the system of commodity tax exemptions available to charities.

The *Excise Tax Act*, which governs application of the federal sales tax, does not recognize or give any special treatment to registered charities, Canadian amateur athletic associations or houses of worship. Schedule III, Part XI, which provides a federal sales-tax exemption for donations of clothing and books for charitable purposes, appears to be the only direct exemption for charitable activities. As a result, incentives or exemptions for charities occur only as by-products of other incentives or exemptions. For example, while the *Excise Tax Act* does not grant specific exemption for charitable organizations, it does grant exemptions to: certified institutions, municipalities, provincial governments, certified public hospitals and schools, universities, public libraries and student residences. Thus, for federal sales tax (FST) purposes, the exemptions available to charitable organizations are limited to those organizations which fall within the definitions set out in the *Excise Tax Act*.

Certified Institutions

Under section 45(1) of the *Excise Tax Act*, a “certified institution” is an institution certified by the Minister of National Health and Welfare to be:

- (a) a bona fide public institution whose principal purpose is to provide care for children or aged, infirm or incapacitated persons; and
- (b) is in receipt annually of aid from the Government of Canada or the government of a province for the care of persons noted above.

For the purposes of Part XIV of Schedule III, a “certified institution” is defined as an institution in Canada which holds a valid certificate issued by the Minister of National Revenue and which has as its main purpose the care of individuals who are blind, deaf and dumb, mentally retarded or in any other way mentally or physically handicapped.

Memorandum ET401 outlines the exemptions available to certified institutions.

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Because institutions can be certified for FST purposes under section 45 and/or under Part XIV, attention should be paid to the differing requirements, entitlements and responsibilities of institutions certified under the two provisions.

Institutions certified under section 45 of the *Excise Tax Act* can obtain FST refunds on the purchase of taxable goods that are for the use of the institution and not for resale. They can also obtain a refund of the excise tax on automobiles. Generally, the FST must be paid on all purchases but certified institutions are entitled to an FST refund. This can be obtained by filing Claim Form N15 within four years of the date of purchase or importation of the taxable goods eligible for refund. Refund procedures are covered in Memorandum ET313.

Institutions certified under section 45 are also eligible for a refund of the FST content of construction contracts for the construction of new facilities and for "substantial" construction contracts for additions, alterations or repairs to the certified institution's buildings as long as the relationship between materials and labour on these contracts is similar to that of contracts for new building construction. If the institution is unable to identify the specific FST content in a construction contract, it may use the simplified method of calculating that content prescribed in ET401. However, caution should be used when the tax factors outlined in ET401 are used since these factors, which also take into account differing provincial sales tax rates, assume the old 12 per cent FST rate.

Certified institutions contemplating construction of a building or building extension or addition, should get in touch with the Department of National Health and Welfare to ensure that the building, extension or addition is certified. Where goods are obtained FST-paid by the institution on or after the date specified in the certificate, a refund claim must be filed within four years of the date the goods were purchased or imported. Similarly, where goods are used in the construction and equipping of an institution and are purchased not more than four years prior to the date specified in the certificate, refund claims must be made within one year of the date on which the certificate was issued by the Department of National Health and Welfare.

Exemptions from FST are also available for goods manufactured or produced by handicapped persons in institutions in Canada that are certified by Revenue Canada. This certification, under Part XIV of the *Excise Tax Act*, provides that where a substantial portion of the sale price is attributable to the labour of handicapped individuals and the labour has been performed in, or exclusively under, the control and direction of the certified institution, the good manufactured are unconditionally FST exempt. It should be noted that certification by Revenue Canada is independent of certification by the Minister of National Health and Welfare under section 45 and does not require that the institution provide residential accommodation or that it receive government funding. Institutions certified under Part XIV are entitled to FST exemption when they purchase articles and materials for use exclusively in the manufacture of goods produced by persons under their control and direction. This exemption is in addition to the general exemption for production equipment, processing materials and plans which is set out in Part XIII of Schedule III of the *Excise Tax Act*.

Quite aside from the problems arising from the limited number of available exemptions, certified institutions face additional difficulties arising from the *Act*. Because FST relief for institutions certified under section 45 is usually provided through refunds rather than by direct exemption, certified institutions are required to maintain additional records and complete extra paper work and also face the inconvenience of waiting for FST refunds. All of this could be avoided if certified institutions were allowed to purchase goods FST-exempt.

Difficulties are also encountered because there has been little elaboration of the definition of certified institutions and because there has been no widespread publicity regarding the incentives available to such institutions. It is quite possible that many organizations which could be certified are not aware of this possibility.

Certain difficulties also exist in the application of FST exemptions for certified institutions. Specifically, the term “substantial” is used to describe the portion of the sale price of goods manufactured in certified institutions which must be attributable to handicapped labour if the goods are to be FST-exempt. However, the term is subjective and no exact definition has been published although 50 per cent or more appears to be the guideline in use. Certified institutions who fail to meet the “substantial” test could be considered to be engaged in manufacturing or marginal manufacturing and accordingly will be subject to FST in the same manner as other businesses.

Hospitals

Part VIII of Schedule III of the *Excise Tax Act* provides an FST exemption for articles and materials purchased for the sole use of any bona fide public hospital (certified as such by the Department of National Health and Welfare) when the goods are purchased in good faith for use exclusively by the hospital and not for resale. Memorandum ET405 outlines the procedures for purchases by bona fide public hospitals and also outlines an FST exemption for articles and materials purchased or imported for use in hospital construction contracts. For hospital construction contracts the Memorandum contemplates exempt purchases either directly by the hospital or by a contractor or subcontractor who is appointed as a purchasing agent for the hospital and uses the hospital’s certificate of exemption. If taxable materials used in the construction of a bona fide public hospital were purchased FST-paid but the FST paid cannot be specifically identified, ET405 provides a simplified method by which contractors can claim an FST refund.

Educational Institutions

Section 46 of the *Excise Tax Act* and ET406 provide certain exemptions for schools, universities, public libraries and student residences. Schedule III of Part III of the *Excise Tax Act* lists educational, technical, cultural, religious and literary exemptions including classroom furniture (but not upholstered chairs); printed books that contain no advertising and are solely for educational, technical, cultural or literary purposes; records and tapes authorized by any provincial Department of Education for French or English instruction; printed matter for use by school boards, schools and universities and not for sale; scientific equipment

designed for use in classroom instruction; and maps, charts, diagrams, posters, films and slides.

The educational institutions listed should also be aware that FST refunds are available on certain construction contracts, i.e., for the purchase of materials used exclusively in the construction of a building for use as:

- a school, university, or other similar educational institution;
- a public library operated on a non-commercial basis; and
- residences for students of universities or other similar institutions.

Memorandum ET406 outlines FST refund procedures both for those claiming by means of specific identification and for those using a formula. It is interesting to note that the ET Memorandum has not been revised to take into account the changes in the customs tariff in item 69605-1 and other exemptions for schools. Historically, the rationale for the 73 1/3 per cent exclusion in the construction formula for nontaxable items used for educational institutions (compared to the 60 per cent exclusion in the construction formula for certified institutions) was that educational institutions received unconditional FST exemption under customs tariff item 69605-1. With the recent repeal of the FST exemptions available under item 69605-1, one would expect that the exclusion for educational institutions would also be revised.

Educational institutions should note that there is no provision for FST refunds for materials used in the repair, alteration and maintenance of existing buildings.

Other Organizations

Amateur athletic associations also do not receive any direct FST exemptions since the Schedule III, Part XV exemption for clothing and footwear specifically excludes most equipment and clothing related to athletics. Again, if the athletic association would qualify in another category, such as a “certified institution”, it is possible that an exemption may apply.

Schedule III of Part III of the *Excise Tax Act* grants exemptions for various goods used in the promotion of religion, including bibles, books, pamphlets and religious pictures but specifically excluding forms, stationery and annual calendars. Although there are no FST exemptions for the construction of religious buildings, it may be possible that a religious or secular school attached to the house of worship and offering a course of instruction that leads to a certificate or diploma, or that is certified by the government, may qualify for educational institutional exemptions.

It is also possible that some charitable organizations may be inadvertently subject to provisions of the FST legislation applicable to commercial enterprises. Charitable organizations engaged in activities which could be classified as “marginal manufacturing” and which quote their income tax registration certificate numbers on their sales-tax-exemption certificates when they are purchasing goods, in the mistaken belief that this registration exempts them from FST are, at the very least, in violation of the letter of the law.

The *Excise Tax Act* contains other general provisions which may be of interest to charitable organizations. Part XVII of Schedule III of the *Excise Tax Act* contains general transportation equipment exemptions. Included in these exemptions are school buses designed to carry 12 or more passengers; buses or vans specifically equipped for transporting handicapped persons which are purchased for use by public organizations or institutions exclusively providing transportation to the handicapped and which would be capable of carrying 12 or more passengers if they were equipped in the normal manner; and motor vehicles designed and permanently equipped to carry 12 or more passengers which will be used exclusively in prescribed passenger transportation services. Part XVII also provides an exemption for parts and equipment which are designed for permanent installation on the above-noted goods if the fair sale price of the Canadian manufacturer or the fair duty-paid value of the imported article exceeds \$2,000 per unit. All parts and equipment installed on the above noted tax-exempt goods prior to their first use are also exempt under this Part.

The *Excise Tax Act*, section 27(4), also contains diversion rules of which taxpayers, including institutions, should be aware. In general, the section states that when motor vehicles, tractors, aircraft, ships or other marine vessels, and certain machines or tools required for their operation, which are obtained FST-exempt, or for which an FST refund has been received, are diverted within five years of their purchase to a taxable use, FST will be payable. The excise tax on automobiles also becomes payable on diversion. (Diversion occurs when an article which was originally tax-exempt is leased, sold, traded or applied to a use which would not have rendered it tax-exempt at the time of purchase. For example, diversion, other than a casual diversion, for private or personal purposes or for commercial gain will incur tax liability. FST and excise tax which become payable on goods diverted to a taxable use are computed on the value of the article at the time of diversion.)

Refund of Excise Tax on Gasoline

Certain purchasers of gasoline, including registered Canadian charitable organizations as defined under paragraph 110(8)(c) of the *Income Tax Act* and registered Canadian amateur athletic associations as defined under paragraph 110(8)(b) of the *Income Tax Act*, are eligible for a refund of the excise tax on gasoline. In order to obtain a refund of excise tax (1.5 cents per litre of tax-paid gasoline) eligible claimants must submit Form XE-8, *Application for a Refund* within four years of the date of purchase of the gasoline. Refund claims for less than \$200 should be filed for the six-month periods ending June 30 and December 31. Refund claims for \$200 or more may be submitted monthly. The amount of any excise tax rebated to claimants will reduce the vehicle gasoline-expense deduction for income tax purposes.

Ontario Retail Sales Tax

In contrast to the federal *Excise Tax Act*, the *Ontario Retail Sales Tax Act* provides definitions for religious, charitable or benevolent organizations. Regulation 904 of the *Retail Sales Tax Act*, section 1.51, defines a religious, charitable or benevolent organization as any organization that is registered under paragraph

110(8)(c) of the *Income Tax Act* and that holds a registration number issued by Revenue Canada. The regulation also defines “school” as including an independent school operated by a religious, charitable or benevolent organization which is defined as a school under the provincial *Education Act*.

Fund-Raising Exemptions

The Ontario exemptions appear more generous and better defined than the federal FST exemptions. For example, section 7 of the Ontario *Retail Sales Tax Act* (RST) exempts from RST the price of admission to any entertainment, dance, performance or exhibition staged or held in a place of amusement, by or under the auspices or sponsorship of certain organizations including:

- (a) a registered Canadian amateur athletic association, as defined by paragraph 110(8)(b) of the *Income Tax Act* and including a branch or affiliate association to which the registration under that *Act* has been extended;
- (b) a registered charity, as defined by paragraph 110(8)(c) of the *Income Tax Act*;
- (c) an educational institution;
- (d) a club, society, association, chamber of commerce, or board of trade organized and operated for any purpose except profit; and
- (e) an organization that is substantially assisted or supported financially from public funds of the Province of Ontario and that is prescribed by the Minister for the purpose of this section.

Organizations not falling within the provisions of section 7 are required to charge tax at the rate of 10 per cent on the price of admission where the price of admission exceeds four dollars.

Ontario has granted other exemptions for fund-raising activities undertaken by religious, charitable, benevolent or nonprofit organizations. When these organizations operate fund-raising events, including bazaars or rummage sales, no RST applies on goods sold by the organization at the fund-raising events if:

- i) the total annual taxable sales at such events do not exceed \$75,000;
- ii) the organization operates only a reasonable number of such events and the events are not scheduled on a regular basis; and
- iii) the organization has paid RST on the cost of goods, other than prepared food products, sold at the fund-raising event.

“Prepared food products” include non-alcoholic beverages, meals, lunches, snacks, and food products sold hot, which are purchased from an eating establishment for consumption on or off the premises and are normally subject to seven per cent RST.

Exempt organizations are, however, required to charge and collect RST on prepared food products sold by the organization on an occasion or at an event sponsored or arranged by another organization or person which contracts with the religious, charitable, benevolent or non-profit organization for catering, or when

the prepared food products are sold on a site or as part of an event where persons in the business of selling prepared food products are also selling prepared food products.

Regular fund raising and certain other activities of religious, charitable, benevolent or non-profit organizations are considered commercial operations. For commercial activities these organizations must obtain vendor permits, purchase goods for resale without tax exemption and must collect retail sales tax on taxable sales. Examples of commercial activities include:

- any regular weekly or monthly fund-raising event;
- operation of a retail outlet (except sales of used adult clothing and footwear totalling \$50 or less which are tax-exempt at such outlets);
- catering;
- selling prepared foods in competition with, or on the same site as commercial operators (at a fair or exhibition, for example); and
- selling alcoholic beverages at licensed premises. (Sales made under a special-occasion banquet permit are tax-exempt.)

Generally, camps run by religious, charitable or benevolent organizations must charge tax in the same way as commercial camps (as outlined in *Ontario Sales Tax Guide #124*). However, camps run by these organizations for disadvantaged persons—such as the handicapped and the indigent—need not charge sales tax.

The *Retail Sales Tax Act*, section 5, exempts from RST any used clothing, used footwear or combination thereof sold by a religious, charitable, benevolent or non-profit organization in one transaction if the total price does not exceed \$50.

Purchase and Other Exemptions

Section 5 of the *Retail Sales Tax Act* exempts certain publications (as defined by the Minister) of religious, charitable or benevolent organizations. Publications of a religious, charitable or benevolent organization are defined in regulation 903, section 1.18A of the *Ontario Retail Sales Tax Act*. Included are: printed matter, books and artwork produced solely for the promotion of religion; printed instructional materials purchased for use and not for resale; and films, filmstrips, video tapes and video discs used to promote the objects of the religious, charitable or benevolent organization and not for commercial exhibition or profit. Excluded from the definition are: directories, price lists, time tables, rate books, catalogues, stationery, forms or similar printed matter. Although the definitions for Ontario RST purposes are similar to the FST exemption under Part III of the *Excise Tax Act*, the legislation is not identical and therefore reference should be made to both the federal and Ontario Acts.

Equipment, as defined, used by religious institutions exclusively on premises where religious worship or Sabbath school are regularly conducted and used exclusively in religious worship or Sabbath school and the repairs to such equipment are RST exempt. Equipment acquired for resale by a religious institution, and clothing and vestments are not included in this exemption.

Religious, charitable or benevolent organizations are exempt from RST on sales of prepared food products when the prepared food products are provided by them to senior citizens or the needy without specific charge or at a nominal charge. Similarly, no RST applies on the sale of prepared food products provided at nominal charge to persons who are disadvantaged or underprivileged or who because of age or an infirmity, disability or handicap, require support. *Ontario Sales Tax Guide #121* lists certain persons who may purchase or receive prepared foods exempt from RST: residents of nursing homes and homes for the aged, shut-ins, the needy, patients in public hospitals and infants attending day care centres where there is no cafeteria. Also students of a boarding school or university are exempt from RST on purchases of prepared food products in an eating establishment operated by, or on behalf of, a school or university, provided that the prepared food products are supplied as part of a meal plan whereby students purchase their meals from the university or school at a single comprehensive price.

A further exemption has been extended to religious, charitable, benevolent or non-profit organizations that manufacture stage props, sets and costumes used in the staging of a live theatrical or musical performance. Ontario RST is levied on the materials used but not on the labour or manufacturing overhead.

Refunds

Motor vehicles purchased by religious, charitable or non-profit organizations are eligible for a refund of RST when they are used primarily to transport people with permanent physical handicaps. A statement to this effect must be attached to the application for refund. When tax is refunded under this program the vehicle must not be operated for profit or gain. Regulation 904, section 32 of the *Ontario Retail Sales Tax Act* and *Ontario Retail Sales Tax Guide #118* provide further information about refunds of vehicle taxes.

Section 45 of the *Ontario Retail Sales Tax Act* provides for an RST rebate to registered religious, charitable or benevolent organizations on goods purchased for use in their real property construction projects. *Sales Tax Guide #131* outlines the conditions under which the rebate of RST under Regulation 904, section 19, is allowed. It should be noted that effective May 14, 1982, the real property construction projects of public hospitals, schools or universities have not been eligible for this rebate. However, if a contractor entered into a written fixed-price or lump-sum contract with a public hospital, school or university prior to May 14, 1982, or if, after that date, the institution accepts an irrevocable offer tendered prior to that date for the construction of buildings which no longer qualify for rebate, the Minister may rebate RST paid by the contractor for taxable property entering into the contract and purchased after May 14, 1982.

The amount of RST rebate which can be claimed when the actual RST paid cannot be identified can be determined by multiplying the total contract price (including architects' fees but excluding land or land-improvement costs, site preparation and demolition charges) by 2.6 per cent for roads and 2.95 per cent for all other structures. Refunds can be made in installments. The amount of an installment is calculated by using the appropriate percentage (above) and the progress payments

required by the contract. Applications for all rebates must be made within three years of the date of the last payment under the contract.

Property Taxation

Section 158 of the *Municipal Act* authorizes municipalities in Ontario (defined as cities, towns, villages or townships, but not counties) to assess, levy and collect taxes upon all real property within the municipality. The *Assessment Act* in turn provides that real property may be taxed in two ways:

- (i) a general property tax levied on the owner of the property; and
- (ii) a business tax levied on the occupant. This is in addition to the property tax on the premises which is payable by the owner of the property.

Owners who occupy their own property for business purposes pay both taxes.

Generally, property taxes are within the administration and control of local authorities in cities, towns, villages, and townships. In areas without municipal organization, the province taxes land and improvements under the provincial *Land Tax Act*, administered by the Ministry of Revenue. The assessment provisions of the provincial *Land Tax Act* are similar to those of the *Assessment Act*, except that there is no business tax assessment.

Ontario assumed responsibility for all real property assessment in 1969 as part of an overall program of municipal tax reform. One component of the reform package was the reassessment of all real property at market value. The market-value assessment proposal has been deferred several times and it is expected that it will be several years before it will be implemented province-wide.

Property taxes are imposed on all real property situated within a municipality, or in an unorganized region in the ways already noted, unless the property is specifically exempted. Under section 3 of the *Assessment Act* exemptions are made for: churches, cemeteries, public educational institutions, religious seminaries, educational seminaries, public hospitals, Boy Scouts and Girl Guides, charitable institutions and Children's Aid Societies. Because each exemption is granted by a particular subsection of the *Act*, each exempting provision should be studied to determine whether a particular institution qualifies for exemption. Generally, however the exemptions are available only where the property is actually owned, used and occupied by the designated institutions.

For example, section 3-12 of the *Act* exempts the land of an incorporated charitable institution which is organized for the relief of the poor, the Canadian Red Cross Society, St. John Ambulance, or any similar incorporated institution conducted on philanthropic principles and not for the purpose of profit or gain and that is supported, in part at least, by public funds, but only when the land is owned by the institution and occupied and used for the purposes of the institution.

Little has been written regarding the interpretation of the exempting provisions of the *Assessment Act*. Published cases regarding exemption for charitable institutions seem to stress the "relief of the poor" criterion for institutions. Some decisions have denied the exemption because the land was not owned by the organization seeking exemption. In another case, private donations to a religious

order were held not to be “public funds” for the purpose of exemption.

The exemptions under section 3 are mandatory. Section 4 grants a further, optional, exemption for religious institutions. Under this provision, the council of any local municipality may pass by-laws exempting from taxes (other than school taxes and local improvement rates) under such conditions as may be set out in the by-law, the land of any religious institution named in the by-law, provided that the land is owned by the institution and occupied and used solely for recreational purposes.

Provincial property taxes applicable to unorganized territories in northern Ontario are levied by the provincial *Land Tax Act*. The principles and provisions of the provincial *Land Tax Act* generally parallel those under the *Assessment Act*. Accordingly, exemptions are granted to places of worship and land used in connection therewith; buildings and grounds used for public educational purposes; buildings and grounds used as a seminary of learning maintained for religious or educational purposes; land owned, occupied and used exclusively by Boy Scouts and Girl Guides; land owned, occupied and used exclusively by an incorporated charitable institution, the Canadian Red Cross Society or St. John Ambulance, etc., that is supported in part at least by public monies; and lands owned by public hospitals. The exemption does not, however, apply when land is occupied by a tenant who is liable for taxation under the provincial *Land Tax Act*. Because of the varying requirements of the exempting provisions, specific reference should be made to each section.

Property tax reform has been an issue in Ontario for some time. It is interesting to note some of the proposals for the reform of property taxation, particularly those related to non-profit and charitable organizations. The report of the Commission on the Reform of Property Taxation in Ontario recommended that church property and convents, cemeteries and religious seminaries remain exempt from taxation. The report also recommended that property owned by charitable and non-profit institutions should continue to be exempt from property tax but that the exemption should remain in effect for a maximum of five years. After that time the organization’s “exempt” status would be subject to review and the decision of an Exemption Review Committee.

The report admits it can offer no ready solution for the tax problems of charitable and non-profit organizations which occupy rented premises and thus continue to pay a property tax component in their rents. Often municipalities decide to make grants to such organizations which are equal to the property taxes payable. Using the argument that such grants should be left to local decision, the report fails to address the discrimination that organizations face when they must operate in several jurisdictions in Ontario. The report also recommended removing independent schools’ exemptions from property tax and recommended that the provincial government provide grants to the schools in the amount of the property taxes paid. A repayment formula was proposed in the event the school property should be sold. Alternatively, if the proposals for property tax reform pertaining to independent schools were not adopted, the committee recommended continuing the exemption.

The debate on the issue of property tax exemptions (the cost of which is generally borne by local municipalities) versus direct funding or grants (the cost of which is generally borne by the provincial government) continues. Those responsible for non-profit and charitable organizations should be aware of the present property tax exemptions and also of the proposals for property tax reform. The whole area of property taxation is often neglected but it may be significant for many charitable organizations.

Charitable institutions paying property taxes should review their assessments to determine whether or not they are appropriate. An opportunity may exist to challenge the assessed value and therefore to reduce the property tax. To do this, the taxpayer wishing to dispute an Assessment Notice must file a Notice of Objection within the time noted in the Assessment Notice. The taxpayer will then have an opportunity to present a case to the Assessment Review Board or, ultimately, the Ontario Municipal Board.

In summary, the rules and practice governing the sales and property taxation of charitable organizations are by no means consistent or clear in their application. This does not decrease the necessity for charitable organizations to study and try to understand them. Since sales and property taxes often represent the largest tax costs charitable organizations bear, tax advisors and those responsible for the management of charitable and non-profit organizations would be well advised to review the applicable legislation and the treatment their organizations have received.