

FACT SHEET Saskatchewan Co-operative Association

There is often confusion among Saskatchewan Co-operators about the relationship of the co-operative business form with non-profit or charitable organization status under Canada Revenue Agency (CRA) guidelines. Below are some common myths and misconceptions about this relationship:

1. MYTH: A co-op can never be a charity or non-profit because co-ops confer a benefit to members.

FACT: Any co-op organized for charitable or non-profit purposes may become be a charity or non-profit, however because members of the co-operative may benefit or gain from the activities of the co-operative, the co-operative must be structured in such a way in their bylaws and Articles of Incorporation that individual members do not benefit to meet the non-profit or charitable purposes test by Canada Revenue Agency (CRA).

2. MYTH: All co-ops are taxed the same.

FACT: The *Income Tax Act* is neutral on corporate form, which is why co-ops can qualify as non-profits or charities and receive exemptions from paying income tax, or in the case of charitable status, have the capacity to issue tax-deductible receipts. Otherwise, the *Income Tax Act* treats the unallocated surplus of a co-op essentially the same way as profit, with some minor differences. Actually, it taxes corporations exactly the same way as “for profit” co-ops, should the corporation distribute patronage dividends based on usage just like a co-op.

3. MYTH: There are no co-ops that are non-profits or charities.

FACT: There are thousands of non-profit co-operatives across Canada. Of the more rigorous charitable status standard, a study done in November 2002, showed there were around 375 Co-operatives in Canada that had registered charitable status, 92 in Saskatchewan alone.ⁱⁱ This means other types of co-ops could fit the non-profit or charitable criteria if they structure the co-op so the members do not individually benefit.

4. MYTH: Only community services co-ops can qualify as non-profit co-ops or charities.

FACT: Only community service co-operatives have a legislative prohibition in section 246 of the *Co-operatives Act* on the paying out of dividends or interest on member shares, possibly leading to the misconception only they can qualify.ⁱⁱⁱ In fact, other co-operatives can simply accommodate this in their Articles of Incorporation or bylaws, thereby precluding their members from gaining an individual benefit from membership and qualifying as non-profits or even charities.

5. MYTH A co-op cannot be a non-profit if it engages in a “commercial” business activity.

FACT: The co-op can be engaged in a commercial or business-like activity so long as it is organized for a non-profit or “non-commercial purpose.” The co-op must state this purpose in its Articles of Incorporation and the co-op must be organized for this purpose. The purpose cannot be contingent on the co-op making a surplus or profit. For instance, a retail co-op that donates all of its profits to disability training organizations will not qualify, but a retail co-op that trains employees with disabilities in the course of its day-to-day business and reinvests any surplus toward that stated purpose will. The purpose of the former is contingent on profitability (it is commercial) but the purpose of latter is not (if the co-op makes no profit it is still fulfilling its stated objectives). Both are operating a retail enterprise.

6. MYTH: A non-profit co-op must operate “at cost” and not make any money.

FACT: Non-profit does not mean that the co-op operates at-cost or at a break-even level. The co-op can generate a surplus. A non-profit co-op just means the co-op is not primarily motivated by the generation of surplus or profit for the benefit of members but rather for the broader social goals that make up the primary purpose of the co-op. In Saskatchewan, community service co-ops are also motivated by social purpose and can generate a surplus.

7. MYTH: A co-op with share capital can never become a non-profit or a charity.

FACT: Most co-op legislation across Canada, but not all, distinguishes between co-operatives *with* share capital and co-operatives *without* share capital. Share capital is a share that is more than a nominal member share, but an equity stake in the co-op. This has led some to believe that this is the distinction between not-for-profit and for-profit co-operatives: that non-profits cannot issue equity shares. This is not true. Canada Revenue Agency (CRA) is indifferent to what form a non-profit organization takes, so long as it fulfills the purposes of being a non-profit. So long as the prohibition on the paying out of dividends and interest on shares exists, and the co-operative is engaged in a not-profit purpose, a co-op with or without share capital can meet the requirements of being a non-profit business under CRA guidelines.^{iv} Indeed there are some cases where a company under a *Business Corporation Act* was held to be a non-profit for duration of time owing to provisions in its founding documents that prohibited the paying out of dividends or interest on shares for non-commercial or charitable reasons.^v Practically, share co-ops that are precluded from paying interest or dividends on shares likely would not issue shares, because there is no economic return to purchase them, so forming co-ops without share capital simplifies the structure.

8. MYTH: Choice of organizational form is easy.

FACT: When starting a new co-op, deciding on the corporate form that will best enable to get the co-op off the ground is often the most difficult decision. Even when one has decided on the co-operative form, deciding between a non-profit, for-profit, and

charitable status co-op is a decision a co-operator will need to make. Depending on the type of co-operative, there may be very high start and entry costs into the market. Whether it be a commercial or non-profit enterprise, both need a solid financial footing in order to succeed.

Please Note: before making a decision of which status to use for your co-op, please seek counsel from a lawyer or someone knowledgeable in co-operative and charitable law

Disadvantages and Advantages of Each Model

For-Profit Co-op Advantages:

- The traditional for-profit co-op structure provides the greatest flexibility in capitalization and attracting investment.
- The co-op can do many things a share company can do:
 - it can borrow money;
 - issue debentures (issue debt to investors);
 - can borrow money from members through member loans;
 - can capitalize by the issuing equity shares to members with a limited return on investment according to patronage;
 - It can issue preferred (non-voting) shares to non-members (outside investors);
 - It can pay dividends and interest on investment;
- Members have a financial incentive to join the co-op;
- Best suited for meeting member economic needs rather than profit motive or a return on investment (where a corporate model may be preferred).

For Profit Co-op Disadvantages:

- The co-op will still need to pay income tax on unallocated surplus;
- The co-op will likely not qualify for many government programs and grants that would be available to a non-profit;
- The co-op will not be able to fundraise and issue tax deductible receipts, or solicit donations from foundations;
- The co-op will need to pay close attention to securities regulations, and weigh the administrative, legal, and accounting costs in its share structure to raise capital.

Non-Profit and Charitable Status Co-ops Incorporation Procedure:

- A co-op that wants to be a non-profit in Saskatchewan must have a provision in its Articles of Incorporation and in its bylaws similar to that found in section 246 of the *Saskatchewan Co-operatives Act* that applies to Community Services Co-ops in order to satisfy Canada Revenue Agency. Specifically the stated objective of the co-op must be in the Articles of Incorporation, as well as that the co-op is carrying on business without the purpose or gain for its members, and that any profit or surplus that the co-op earns will be used for the purposes of promoting the stated object of the co-op;

- A charitable status co-operative is a non-profit co-op that has applied for and has been registered as a charitable organization with CRA. It is a much stricter criteria with narrow purposes than to what a non-profit must adhere.
- A lawyer knowledgeable in the field should be consulted prior incorporation as a non-profit or application for charitable status.

Non-profit Co-op Advantages

- Non-profit co-ops are exempt from paying income tax;
- The co-op can engage in commercial-like activities but only so long it is pursuing a non-commercial purpose and that any surplus goes toward that stated purpose.
- The co-op can qualify for many government programs and grants.

Non-Profit Co-op Disadvantages

- The co-op cannot issue shares that will pay dividends or interest on share capital. This may make it difficult to attract members, and to raise capital;
- While a non-profit can solicit for donations, it cannot issue tax deductible receipts
- A non-profit co-op cannot receive charitable funds unless it is a qualified donee (a charity). Any charity may have the capacity to contract a non-profit to act as its agent in limited circumstances to carry out its charitable purposes, but in such cases the non-profit is acting only as an agent for the charity in control. Careful consultation with a lawyer is paramount.

Charitable Status Co-op Advantages

- The co-op has the ability to issue tax deductible receipts to fundraise and solicit for charitable donations as a means of capitalization;
- The co-op has the ability to solicit charitable foundations as pools of capital;
- The Co-op has the ability to leverage the increased credibility charitable status entails given the increased rigour that they are regulated into support.

Charitable Co-op Disadvantages

- A co-operative charity is prohibited in the same way as non-profits on the paying out of dividends and interest on share capital, except that all assets must be given to other charities on dissolution;
- A charity is severely restricted in any commercial activities: a related business must be subordinate to the charitable purpose and a necessary offshoot to the core programs;
- The co-op must go through much more rigorous scrutiny with CRA and the scope of activities is limited to four narrow charitable criteria (relief of poverty, education, religion, and other purposes “beneficial to the community”);
- The co-op is restricted in its political/lobbying activities.

Advantages of being For-Profit, Non-Profit, and Charitable Status Co-operatives

Advantage	For-Profit	Non-Profit	Charitable
No restrictions placed on shares in Articles / bylaws	✓	✗	✗
Allowed to pay dividends on shares	✓	✗	✗
Allowed to pay interest on shares	✓	✗	✗
Broad purpose, need not have non-profit purpose	✓	✗	✗
Need not have a charitable purpose	✓	✓	✗
Few restrictions on lobbying or political activities	✓	✓	✗
Few restrictions on commercial activities if in co-op's purpose	✓	✓	✗
Not restricted to distributing to charities upon dissolution	✓	✓	✗
No high reporting criteria and accounting costs	-	✓	✗
Can qualify for some government funding / granting agencies	✗	✓	✓
Co-op is exempt from income tax	✗	✓	✓
Allowed to issue tax deductible receipts	✗	✗	✓
Can receive money from charities or charitable foundations	✗	✗	✓
Public credibility and prestige as a charitable organization	✗	✗	✓

ⁱ *Income Tax Act*. R.S.C. 1985, c. 1

ⁱⁱ Bridge, R. (2003) *Co-operatives and Charity Law*. Canadian Co-operative Association, BC Region

ⁱⁱⁱ *Co-operatives Act*, R.S.S. 1996. c. C-37-3

^{iv} Canada Revenue Agency. Interpretation Bulletin IT-496R, dated August 2, 2001

^v *Gull Bay Development Corporation v. H.M.Q.* 84 DTC 6040 (F.C.T.D.).