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Planning Opportunities for Public Sector Bodies

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This paper examines ways in which the confusing rules and exceptions to the general principles of the *Excise Tax Act* and provincial sales tax (PST) legislation can be turned to the advantage of public sector bodies.

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With complexity comes opportunity. Unfortunately, complexity also brings misunderstanding and frustration. Much of the current commentary on public sector bodies and Canadian sales taxes focuses upon the latter. This paper, however, will examine ways in which the perplexing labyrinth of special rules and exceptions to the general principles of the *Excise Tax Act* and provincial sales tax (PST) legislation can be turned to the advantage of oft under resourced public sector bodies.

Background

To put some perspective around the size of this sector, at present there are approximately 83,500 charities registered in Canada under the *Income Tax Act*.¹ Unfortunately, there is no similar measure of non profit organizations since no formal registration is required. This number includes both large charities such as hospitals, universities and national organizations with full administrative staff and budgets in the hundreds of millions of dollars, to small charities such as daycare centres with budgets of less than \$ 100,000. Although large charities and non-profit organizations have competent full-time administrative staff, they often wear many hats and are not afforded the luxury of being able to devote a sufficient amount of time to deciphering the complexity of the sales tax rules with which they are faced. The same is true for the thousands of individuals who have voluntarily taken on finance and accounting responsibilities for smaller charities and non-profit organizations.

For purposes of the *Excise Tax Act* the term public sector body is defined to mean “a government or a public service body.” Government is defined to mean “Her Majesty in right of Canadian or a province” (i.e., federal and provincial governments) and a public service body is defined to mean, “a non-profit organization, a charity, a municipality, a school authority, a hospital authority, a public college, or a university.” As federal, provincial, and municipal governments do not generally incur unrecoverable Goods and Services Tax/Harmonized Sales Tax (GST/HST), this paper focuses on GST/HST opportunities for public service bodies other than municipalities. The provincial sales tax (PST) opportunities presented relate specifically to charities in Ontario and British Columbia.

As noted previously, the *Excise Tax Act* definition of public service body includes school authorities, hospital authorities, public colleges, and universities. While these types of entities are typically registered charities under the *Income Tax Act*, they are excluded from the definition of charity in the *Excise Tax Act* and are defined to be “public institutions.” It is important to make that distinction for GST/HST purposes because the rules determining the tax status of supplies made by charities are markedly distinct from those determining the tax status of supplies made by other public sector bodies, including public institutions. In brief, supplies made by charities are generally exempt unless specifically identified as being taxable under Part V.1 of Schedule V of the *Excise Tax Act*, whereas supplies made by other public sector bodies, including public institutions, are generally taxable unless specifically identified as being exempt under Part VI of Schedule V.

¹ Statistics provided by the Canadian Revenue Agency.

Like other GST/HST registrants, and absent specific sector rules, public service bodies that make taxable supplies can recover GST/HST incurred on property or services acquired or imported for consumption, use, or supply in the course of commercial activities (e.g., the making of taxable supplies) by claiming input tax credits against any GST/HST that may have become collectible in a particular reporting period. However, unlike other entities, public service bodies are generally entitled to claim a partial rebate, (as outlined in Figure 1) of GST/HST incurred on property or services acquired or imported for purposes relating to their exempt activities.

Figure 1

	GST	NB HST	NS HST	NF HST
Charity	50%	50%	50%	50%
Qualifying NPO ²	50%	50%	50%	50%
University/Public College	67%	0	67%	0
School Authority	68%	0	68%	0
Hospital Authority	83%	0	83%	0
Municipality	100%	57.14	57.14	0

The complexities associated with the GST/HST rules for public service bodies include determining whether a supply is taxable or exempt, and determining whether an input relates to taxable or exempt activities. If an input relates to both, the further challenge is to accurately apportion the input so as to claim the appropriate recovery. The GST/HST opportunities presented herein focus upon maximizing input tax credits and rebates and altering the characteristics of supplies made by public service bodies to make them taxable, again for the purpose of maximizing GST/HST recovery.

For PST purposes, the rules for public service bodies are more straight forward: the sale of property or services by public service bodies is generally subject to tax in the same manner as for-profit entities; and purchases (including rental, lease, or license) and the importation of property or services are generally subject to tax in the same manner as purchases made by for-profit entities. Notable exceptions are found in the provinces of Manitoba and Ontario that permit charities to sell otherwise taxable property or services for fundraising purposes without charging PST. Additionally, Ontario is the most generous of the PST provinces in that it provides exemption for certain otherwise taxable property and services purchased by universities, hospitals, religious institutions, and not for-profit medical research institutions.³

The PST opportunities detailed herein relate to specific rebate opportunities that exist with respect to Ontario Retail Sales Tax incurred in capital construction projects, and British

² Subsection 259(2) of the *Excise Tax Act* provides that “a person is a qualifying non-profit organization at any time in a fiscal year of the person if, at that time, the person is a non-profit organization and the percentage of government funding of the person for the year is at least 40%.”

³ Paragraphs 38, 53, 18, and 53 of Subsection 7(1) of the *Retail Sales Tax Act*.

Columbia Social Service Tax where medical equipment is purchased using funds provided by a registered charity or a member of the British Columbia Association of Health Care Auxiliaries.

GST/HST Issues

Section 211 Election – Election by a Public Service Body to Have an Exempt Supply of Real Property Treated as a Taxable Supply

One of the more common elections for public sector bodies is the election found under section 211 of the *Excise Tax Act* (the “211 Election”). This election is often described as the election to make an otherwise exempt supply of real property taxable. It does much more than that, however. Not only does it make supplies of certain real property taxable and give rise to input tax credits in respect of related inputs, but it also alters the manner in which a public service body claims input tax credits in connection with the acquisition of or an improvement to capital real property. The election may be made either upon or subsequent to acquiring or improving real property. The following section examines the effect of making the election subsequent to the acquisition of or improvement.

Absent the 211 Election, section 209 and subsection 199(3) apply respectively for the purposes of determining whether a person is entitled to an input tax credit upon acquiring or improving capital real property and the degree to which a change in use may either trigger an input tax credit increase or a recapture of an input tax credit previously claimed.

In brief, Section 209 provides that a public service body may claim an input tax credit when capital real property is acquired or improved upon for use primarily (i.e., 50% or greater) in commercial activities. Where such property or improvements thereto are intended to be used primarily in commercial activities, a full input tax credit is available. If the intended use is less than primary, no input tax credit is available. Clearly, since the degree of entitlement is not closely linked to the actual use of the property, it would be unlikely that the input tax credit entitlement of a public service body would accurately reflect its use of the property in commercial activities.

Similar to input tax credit entitlements, the change-in-use rules provided for in subsection 199(3) only apply where use of the property in commercial activities either increases to primary use or decreases to less than primary use. Where a public service body’s use of capital real property increases to primary use, the person is deemed to have acquired the property at that time, is deemed to have paid GST/HST equal to the basic tax content,⁴ and is therefore entitled to an input tax credit equal to this amount. Conversely, if use decreases to less than primary use, the person is deemed to have sold the property, is deemed to have collected GST/HST equal to the basic tax content, and is therefore required to remit tax equal to this amount.

To summarize, in the absence of a 211 Election, the input tax credit entitlement of a public service body is an “all or nothing proposition.” There is no in between, or partial input tax

⁴ Defined in subsection 123(1) of the *Excise Tax Act*.

credit, as there is for other GST/HST registrants who are generally entitled to proportionate input tax credits, based upon the intended use in commercial activities, provided that use in commercial activity is greater than 10%.

While it is true that the primary use test for input tax credits could, in some instances, benefit a public service body, resulting in full input tax credits where capital real property is used less than exclusively in commercial activities, it is more often the case that a public service body will be denied input tax credits because it does not meet the primary use test. The result, in the former instance, is that certain public service bodies can acquire what is likely to be their most valuable asset on a tax free basis whereas others, whose use of capital real property could in theory only be 1% less, would be denied any claim for input tax credits. This is arguably an inversion of value added tax principles in that it either results in a public service body being fully relieved of a tax burden in respect of its exempt activities, or facing a tax burden in respect of its taxable supplies.

The 211 Election, re-establishes the proper application of value added tax principles to this sector. Once this election is in place, a public service body's input tax credit entitlements and change of use obligations are determined by section 206, which provides that the input tax credit entitlement is equal to the degree to which the capital real property has been acquired for use in the public service body's commercial activity. In other words, if a public service body acquires such property for use 40% in a commercial activity, it claims an input tax credit equal to 40% of the tax paid or payable. Additionally, a charity, qualifying non-profit organization, or a selected public service body,⁵ can claim a portion of the remainder of the GST/HST by way of rebate under Section 259 of the *Excise Tax Act*.

In addition to giving a rise to input tax credits on a proportional use basis, a 211 Election also deems the electing public service body (i) to have made a supply of the property by way of sale and to have collected GST/HST equal to the basic tax content; and (ii) to have acquired the property by way of sale and to have paid GST/HST equal to the basic tax content. An input tax credit entitlement will arise on the deemed sale, under subsection 193 (1).

Although the 211 Election is commonly referred to as the "Election...by a Public Service Body to Have an Exempt Supply of Real Property Treated as a Taxable Supply,"⁶ section 211 of the *Excise Tax Act* does not require that a supply of the real property be exempt in the absence of the election. In other words, a public service body may make the election in respect of capital real property, the supply of which is already taxable, such as the supply of a right to park made by a university. In this instance, the effect is essentially that the electing public service body will determine its input tax credits relating to the acquisition of or improvement to the property in the same manner as other GST/HST registrants.

⁵ Defined by subsection 259(1) of the *Excise Tax Act* to mean, "(a) a hospital authority, (b) a school authority that is established and operated otherwise than for profit, (c) a university that is established and operated otherwise than for profit, (d) a public college that is established and operated otherwise than for profit, (e) a municipality, (f) a facility operator, or (g) an external supplier".

⁶ Form GST 26E

As with any other election that may be made under the *Excise Tax Act*, whether the 211 Election is advantageous depends upon the particular circumstances of the person. In this regard, if a public service body uses capital real property exclusively in commercial activities, making the 211 election would be neutral, and therefore not practical, since it would be entitled to full input tax credits whether or not it makes the election. Similarly, there would be no benefit in making the 211 Election if a public service body uses capital real property less than 10% in commercial activities as it would not be entitled to any input tax credit regardless of whether it makes the election.

If a public service body uses the property primarily, but not exclusively, in commercial activities, making the 211 Election would be detrimental, since it would reduce tax recovery from full input tax credit entitlement to a mix of partial input tax credits and partial rebate recovery, which would fall short of 100% in all instances.

It is only in situations where a public service body uses capital real property between 10% and 50% in commercial activity, that a 211 Election may be beneficial. The degree to which a public service body uses capital real property is only one factor to consider in determining whether a 211 Election is beneficial. Other factors to consider include, the degree to which GST/HST recovery will be increased; the effect or perceived effect it would have on tenants; the complexity of making the election; the effect it would have upon input tax credits relating to operating expenses; the effect it would have upon the ultimate sale of the property; and the implications of revoking the election at a later date.

The degree to which recoverable GST/HST will increase for an electing public service body will depend upon the specified percentage /specified provincial percentage that the person uses in calculating its GST/HST rebate and the degree to which the person uses or will begin to use the real property in the course of commercial activities. In essence, the lower the specified percentage / specified provincial percentage and the higher the use in commercial activity, the greater the increase in recoverable GST/HST. For example, for an Alberta university that uses / will use real property 15% in the course of its commercial activities, the increase in recoverable GST would be relatively low presuming it would have been entitled to an 67% rebate absent the 211 Election. However, for a university located in New Brunswick that uses/will use property 40% in commercial activities, the increase in recovery would be significant considering that in the absence of making the election its rebate would have been limited to 67% of the federal component of the GST/HST incurred, with no recovery of the provincial component.

Whether or not tenants will accept the addition of GST/HST to their rent bill will depend upon the degree to which they are entitled to recover the tax. With the exception of entities that are not qualifying non-profit organizations and small suppliers,⁷ many commercial tenants of public service bodies would likely be entitled to at least partial GST/HST recovery. Accordingly, commencing to collect GST/HST on previously exempt supplies of real property should not, in theory, have too negative an impact on the tenants of public service bodies that make the 211 Election.

⁷ Determined by section 148 of the *Excise Tax Act*.

While the making of a 211 Election appears straightforward on the surface, it is in fact quite complex. The complexity is two fold. First, upon making the election, the electing party must determine the basic tax content for the purpose of calculating the tax that is deemed to have been collected, the tax that is deemed to have been paid, and the input tax credit to which the electing party is entitled. Second, the electing party must establish a fair and reasonable⁸ method to support the degree to which the subject property is/will be used in the course of commercial activities. It should be noted that the allocation methodology used by a person to determine its input tax credit entitlement is generally left to the discretion of the person.⁹ It has been determined by the courts that an allocation methodology established by a person is not required to be the *most* fair and reasonable, but only that it *is* fair and reasonable.¹⁰ For example, notwithstanding that an output-based (e.g., revenue-based) method may be the *most* fair and most reasonable of methods possible, if an input-based method (e.g., area measurement) *is* fair and reasonable in the circumstances, the latter may be used to determine a person's input tax credit methodology.

The effect of making the 211 Election on input tax credits for operating expenses is neutral since, subject to Section 141 of the *Excise Tax Act*, a public service body will generally determine its input tax credit entitlement for services and non-capital personal property based upon the degree of use in commercial activity in accordance with the general rules established by subsection 169(1), regardless of whether it enters into a 211 Election. Section 141 provides that where all or substantially all (generally accepted as 90% or more) of the consumption or use of property or a service is in a person's commercial activity, the person shall be deemed to use or consume the property 100% in the course of commercial activities and therefore be entitled to claim a full input tax credit; where consumption or use is substantially in an exempt activity, the person is deemed to use or consume the input 100% in an exempt activity and is therefore not entitled to claim an input tax credit.

Absent a 211 Election, the supply of real property by way of sale is generally exempt by virtue of Section 25 of Part VI of Schedule V for public service bodies, and section 1 of Part V.1 of Schedule V for charities. However, if the 211 Election is in effect, the supply of the subject property will be taxable, triggered by paragraph 25(g) of Part VI of Schedule V for public service bodies and paragraph 1(m) of Part V.1 of Schedule V for charities. As such, in the event that a public service body intends to sell real property for which a 211 Election is in place, it is advisable to consider the GST/HST impact for the purchaser. If the purchaser is a GST/HST registrant that will use the property exclusively in commercial activity, the application of tax to the sale of the property is of little consequence. However, if the purchaser is entitled to less than full GST/HST recovery, the application of tax to the supply of the property could be an impediment.

⁸ 141.01(5) of the *Excise Tax Act*.

⁹ The exception is that proposed section 141.02 dictates the manner in which financial institutions must determine their input tax credits.

¹⁰ *Ville de Magog v The Queen* [2001] 3030 ETC and *Bay Ferries Limited v The Queen* [2004] 3075 ETC.

If it is preferable for the sale of capital real property not to attract GST/HST, the electing public service body may wish to revoke the 211 Election. The effect of revoking the election is essentially that the public service body will lose its entitlement to the input tax credit it had claimed upon making the election. Upon revocation, 211(4) deems the public service body to have made a supply of the property by way of sale and to have collected tax in respect of the supply. This subsection also deems the public service body to have received a supply of property by way of sale and to have paid tax in respect of the supply. The amount of tax attributable to the deemed sale and acquisition is equal to the basic tax content. As such, the net tax of a public service body that revokes a 211 Election will be equal to the tax it was deemed to have collected minus its rebate entitlement in respect of the tax it is deemed to have paid. If a public service body revokes the 211 Election prior to selling real property, the amount of net tax it had to remit should taken into consideration when it determines the selling price of the real property.

Should a public service body determine that making a 211 Election is beneficial, it must:

- Make the election in prescribed form and include prescribed information. The prescribed form is GST 26 which identifies the prescribed information that must be provided;
- Specify the real property in respect of which the election applies and specify the day upon which the election is to become effective. In this regard the CRA has indicated that for the purpose of this election, it considers the term real property to mean real property that comprises a single legal description.¹¹ An election may therefore not be made with respect to a portion of the real property included in a single legal description. For example, a university may not elect to have one of its 25 buildings be subject to the 211 Election if they are all part of the same legal description. If the election is made, it would apply to all 25 buildings; and
- File the election within one month after the end of the reporting period in which the election is meant to become effective. It seems that the CRA is quite strict on this point in that it has ruled that it will not accept an election more than one month after the end of the particular reporting period.¹²

The following example illustrates the benefit of making the 211 Election to a Newfoundland university, in respect of its establishment of a new campus.

¹¹ GST/HST Interpretation Letter, Case Number 63065, dated October 7, 2005, confirms CRA's position that, "For the purposes of section 211, "real property" means the entire estate or interest in real property held by a person. It is an area of land included in a single legal description, an entire leasehold interest of a person or the smallest legal parcel of land that includes the property in respect of which a person intends the election to cover."

¹² GST/HST Application Ruling, Case Number 30974, dated March 28, 2001.

Example

- The university established a new campus on what was previously bare land;
- The university paid consideration of \$5,000,000 plus \$ 650,000 of HST on the purchase of the land;
- The university hired a contractor to develop the land and to construct a five storey, 300,000 square foot building consisting of lecture halls, a student centre and a recreation centre, and a three storey, 100,000 square foot parking garage. The total consideration payable for the development/construction is \$ 50,000,000 plus \$ 6,500,000 of HST;
- The university uses the five storey building exclusively in the making of exempt supplies and does not make supplies of any portion of the building by way of lease, license or similar arrangement to any third party;
- The parking garage is used exclusively in making taxable supplies of parking. The university is registered for GST/HST and collects and remits tax in respect of such supplies;
- The university did not claim an input tax credit with respect to the development of the land and construction of the structures since it did not acquire the land or the improvements thereto for primary use or consumption in the course of its commercial activities;
- The university claimed a public service body rebate equal to 67% of the tax payable under section 165(1) (i.e., the Federal component of the GST/HST). The university claimed no rebate in respect of the tax payable under section 165(2) since its “specified provincial percentage” is 0%. Accordingly, the total rebate claimed by the university for the acquisition and construction was \$ 1,842,500 (67% of the \$ 2,750,000 payable under subsection 165(1));
- The total amount of unrecoverable GST/HST in connection with the acquisition and development of the land is \$ 5,307,500;
- If the university were to make the 211 Election, the total amount of unrecoverable GST/HST in respect of the acquisition and development of the property could be reduced by \$ 1,326,875 (summarized in Figure 2);
- Upon making the election, the university is:
 - Deemed to have made a supply of the property by way of sale and to have collected GST/HST equal to the basic tax context - \$ 5,307,500;
 - Deemed to have received a supply of the property by way of sale and to have paid GST/HST equal to the basic tax context - \$ 5,307,500;
 - Entitled to claim an input tax credit equal to the extent to which it acquired the property for use in its commercial activity. The university has determined that an input based method using square footage is fair and reasonable for the purpose of determining the

use of the real property in the course of its commercial activities.¹³ Since the square footage of the parking garage is equal to 25% of the total square footage and since the parking garage is used exclusively in commercial activities, the university has calculated its input tax credit in respect of the deemed acquisition to be equal to 25% of the GST/HST that is deemed to have been paid - \$ 1,326,875;

- Not entitled to claim a rebate in respect of tax deemed to have been paid under paragraph 211(1) (b) since tax that is deemed to have been paid is excluded from the definition of “non creditable tax charged”;
- Entitled to claim an input tax credit by virtue of subsection 193(1) equal to the basic tax context - \$ 5,307,500; and
- The university’s net tax calculated upon making the 211 Election would be \$1,326,875.

Figure 2

<u>Prior to Making the 211 Election</u>	
GST/HST payable on acquisition of land	650,000
GST/HST payable on land development & construction	6,500,000
Rebate in respect of land, development & construction	<u>(1,842,500)</u>
Net tax	5,307,500
<u>Upon Making the 211 Election</u>	
GST/HST collectable in respect of deemed supply	5,307,500
ITC in respect of deemed acquisition	(1,326,875)
ITC in respect of deemed supply	<u>(5,307,500)</u>
Net Tax	(1,326,875)

Making the 211 Election would clearly be beneficial for the university since the property is not used primarily in its commercial activity, however, there is still commercial use, and its overall rebate entitlement is relatively low.

¹³ An input-based methodology using square footage measurements to determine the degree of use in the university’s commercial activity has been chosen for the sake of simplicity and is not meant to imply that the CRA or the courts would necessarily accept this methodology as being fair and reasonable.

Section 129 – Election to Treat Branches or Divisions of Public Services Bodies as Small Suppliers

Section 129 of the *Excise Tax Act* provides that a public service body may elect, in certain instances, for its branches or divisions to independently determine whether they qualify as small suppliers under section 148 (the “129 Election”). Absent the 129 Election, a public service body is required to take the activities of all branches and divisions into account in determining whether the body as a whole qualifies as a small supplier. In brief, section 148 dictates that a public service body is a small supplier and is therefore not required to register for GST/HST if the value of consideration for taxable supplies made by the person, including its branches and divisions in a single calendar quarter or cumulatively in the four previous consecutive calendar quarters does not exceed the total of \$ 50,000.¹⁴

If a public service body does not qualify as a small supplier and is required to register for GST/HST, all supplies that it makes, other than exempt supplies, will be subject to GST/HST. If it qualifies as a small supplier and does not register for GST/HST, any otherwise taxable supplies that it makes, while not technically exempt supplies, will be treated as such in the sense that GST/HST will not apply and no input tax credit entitlement will exist. Supplies made by small supplier divisions or branches of a public service body will be treated in the same manner if a 129 Election is made even though the entity is registered for GST/HST. For example, if a non-profit organization that has three distinct operating divisions makes the 129 Election in respect of two of the divisions, those two divisions will act as non-registered small suppliers (e.g., will not collect GST/HST on otherwise taxable supplies and will not be entitled to input tax credits), regardless of the fact that the organization remains registered for GST/HST. Whether entering into a 129 Election is beneficial or desirable to a particular public service body will therefore depend upon whether it prefers that its supplies be taxable.

The prevalent thinking by public service bodies currently seems to be that making exempt supplies is desirable to making taxable supplies, presumably because it will result in some sort of a competitive edge, provide financial relief to their customers, or it may be perceived to be in alignment with the non-taxable status of not for profit entities under the *Income Tax Act*. If a public service body subscribes to this thinking, it will likely do whatever it can to preserve the tax exempt / relieved status of the supplies it makes and would likely choose to make the 129 Election if its branches or divisions qualify. However, other public service bodies that question the status quo realize that the fact that certain supplies made by public service bodies are exempt is what gives rise to the complexity of administering their GST/HST. As such, they are likely to look for opportunities for their supplies to be taxed under the general principles of the *Excise Tax Act*.

It is not simply the sales tax philosophy of a public service body and the GST/HST implications on future supplies that should be considered in determining whether a 129 Election should be made. For example, where branches and divisions qualify as small suppliers and the 129 Election is made, the public service body is deemed to have made a supply of any property, other than capital property or on improvement thereto, held for consumption, use, or supply, by

¹⁴ In certain instances where a person makes taxable supplies of the right to participate in a game of chance or other gambling activity, the value of prizes awarded must be added to the 50,000 threshold account.

its small supplier branches or divisions and to have collected GST/HST unless the deemed supply would be exempt under Parts V.1 or V1 of Schedule V. The amount of tax deemed to have been collected and therefore required to be remitted is equal to the input tax credits that the public service body previously claimed in respect of the property or was entitled to claim.

Of note is that although section 129 does not deem the public service body to have paid tax in respect of the deemed supply or to have received the supply, as do other self-supply sections of the *Excise Tax Act*, the definition of “non-creditable tax charged” in subsection 259(1) includes the tax that was deemed to have been collected under subsection 129(6), thus giving rise to a rebate under section 259.

In conclusion, in determining whether to make the 129 Election, a public service body must consider both the immediate and future implications of making the election. The greatest immediate implication is how much unrecoverable tax will be incurred by entering into the election. For example, if a particular branch of a registered non profit organization that is not entitled to GST/HST rebates held a significant amount of property for use in its commercial activities prior to entering into the election, it would have an absolute GST/HST burden. Of course, the burden would be lessened if the electing public service body were entitled to a partial rebate, or if the value of property held for consumption, use or supply in a branch or division’s commercial activities prior to making the election was negligible.

Future implications include the on-going burden of unrecoverable tax as well as the future tax status of supplies. A public service body needs to consider whether the recipients of its supplies would object to the payment of tax so vehemently that they would cease to acquire the goods or services. If the recipients are fully engaged in commercial activity, the GST/HST is clearly a non-issue. If the recipients are engaged in exempt activities but are entitled to partial GST/HST rebates, they will incur some unrecoverable tax on taxable purchases. If the recipients are individuals or are not entitled to rebates or input tax credits, they will bear the full burden of the applicable GST/HST. However, a public service body contemplating the 129 Election should consider that people may not be as opposed to paying GST/HST as we once were. Nearly into our 19th year of the tax, people have acclimatized to paying the tax. As well, as a result of the recent rate reductions, paying GST/HST is less of a financial burden on end users than it was previously.

Causing Otherwise Exempt Supplies to Become Taxable

As discussed above, the allure of the tax exempt supply to customers may have passed and it may be time for public service bodies to minimize their exempt supplies if possible. As a general rule, supplies made by a charity are exempt of GST/HST unless identified as being taxable by the exclusions provided in section 1 of Part V.1 of Schedule V. Currently, supplies of other public service bodies are generally taxable unless identified as being exempt in sections 2 through 28 of Part V1 of Schedule V. As this section examines, there are many opportunities for public service bodies to make minor adjustments to the nature of otherwise exempt supplies they make, to cause them to become taxable.

In considering whether it wishes to maximize its commercial activities, a public sector body should consider the overall impact of its decision. The primary reasons for shifting to a predominantly taxable rather than an exempt operating model are that it would potentially increase GST/HST recovery (e.g., full ITCs rather than partial or no rebate entitlements) and decrease compliance complexities (e.g., reduce the incidence of having to allocate between rebates and input tax credits). As discussed previously, it must also be considered that paying GST/HST in 2008 may be less of an issue, from a recipient's perspective, than it was in the early 1990s when there was much public outcry over the new tax. Additionally, many recipients of supplies made by public service bodies are entitled to full or partial GST/HST relief, for example, the federal government recovers GST/HST paid by way of an internal adjustment, provincial governments are entitled to point of sale relief, and most other public service bodies are entitled to claim full or partial GST/HST rebates.

It must also be considered that the overall GST/HST burden upon public sector bodies has decreased in recent years as a result of the cumulative 2% rate reductions since a reduction in rebate percentages did not accompany the rate changes. With the rate reduction, full recoverability of tax is less of a benefit than it would be in a country with a high rate of VAT. Notwithstanding that there may not be as much to gain by making supplies of a Canadian public sector body taxable, as there would be in higher VAT rate jurisdictions, doing so may nevertheless produce financial and compliance benefits.

The complexity of a planning opportunity must also be considered given the fact that most public service body administrators are under-resourced and over-tasked. Following is a summary of exempt supplies that could be altered with little effort to produce taxable results.

Section 3 of Part V.I and Section 3.1 of Part VI generally provide that the supply of tangible personal property or a service by a charity or public institution, respectively, in the course of a fundraising activity, will be exempt unless the person make such supplies throughout the year or a significant portion of the year. While the *Excise Tax Act* does not define "significant portion of the year," the CRA has verbally advised that it considers the phrase to mean 30% of any 12-month period.

In order to cause supplies made through fundraising activities to be taxable, the charity or public institution should ensure that it makes the property or service available for more than 30% of any 12-month period. Accordingly, where feasible, the charity or public institution may wish to ensure that it make such fundraising property or services available for more than 15.5 weeks of a given 12-month period, by continuing to offer such goods or services for sale on its website or through its periodic newsletter.

For example, in order to raise funds for its affiliate hospital, a hospital foundation intends to make supplies of calendars by way of sale. Considering that the peak opportunity to sell calendars falls within November and December of the previous year, the foundation determines that it will set up a kiosk in the lobby of the hospital to sell the calendars throughout these months. Since a two month period would only represent approximately 16.5% of a 12-month period, the supplies would be exempt by virtue of these sections. However, if the foundation continued to make the calendars available either through its website or through its own office

until the end of February, its fundraising event would run through a significant part of the year and supplies of the calendar would be taxable provided that no other exempting provisions of the legislation apply.

Without taking the step of prolonging this fundraising campaign for an additional two months, the supply of the calendars would be exempt and the foundation would only be entitled to a 50% recovery of its input GST/HST as opposed to a presumably greater recovery if its net tax is calculated under the Simplified Accounting Method for Charities or full recovery if it can opt out of the Simplified Method. Charities that make supplies outside of Canada or zero-rated supplies in the ordinary course of business or whose taxable supplies are all or substantially all of the supplies they make may elect not to calculate their tax using the Simplified Method. Additionally, since calendars are generally subject to GST/HST, there is no competitive disadvantage to the foundation if it takes the steps to make its calendars taxable. It also seems unlikely that not taxing the calendars would result in a competitive advantage since the purchasers of the calendars, likely individuals, are not purchasing the calendars just because they need calendars, but also because they wish to support the affiliated hospital.

Section 4 of Part VI provides exemption for certain supplies of tangible personal property made by public sector bodies if four specific conditions are met. It should be noted that no equivalent exemption applies for charities. The specific criteria for exemption are:

- a) the body does not carry on the business of selling such property;
- b) all the salespersons are volunteers;
- c) the consideration for each item sold does not exceed \$5.00; and
- d) the property is not sold at an event at which supplies of property of the kind or class supplied are made by persons who carry on the business of selling such property.

Whether or not the public sector body carries on the business of selling such property is a question of fact and one that could not likely be determined without significant analysis, which the body may not be interested in undertaking. Additionally, the nature of supplies made by other vendors cannot be controlled. The variables that are within a public sector body's control, however, are the amount of consideration charged and whether the sales people are employees or volunteers. Since section 4 requires that all four criteria must be met, as long as one of the four is not met, supplies of tangible personal property made by a public sector body will escape exemption. Accordingly, if a public sector body, other than a charity, wishes its supplies of tangible personal property to be taxable, it should ensure that the value of consideration exceeds \$5.00 or that at least one of the salespeople is an employee. Provided that no other exempting provision applies, such supplies would be taxable and the supplier would be entitled to full input tax credits.

Section 5.1 of Part V.1 and Section 6 of Part VI provide GST/HST exemption for charities and other public service bodies (excluding municipalities), respectively, when the consideration charged for the supply of tangible personal property or a service acquired for the purpose of

resupply does not exceed the direct cost¹⁵ of the property or service. Since the supplier of property or services is generally free to establish the consideration payable for the supply it should be relatively easy for a charity or other public sector body to escape this exemption, provided that no other exempting provision applies.

In order for the preceding three opportunities for public sector bodies to cause otherwise exempt supplies of tangible personal property or services to be taxable, all of the following conditions must be met.

For charities, supplies of property must be new property (since supplies of used tangible personal property are not excluded from the general exemption); the consideration for the supply must exceed direct cost; and if the supply is made in the course of the fund raising activity, supplies of the property must be made as part of that activity for greater than 15.5 weeks in a 12-month period.

For public sector bodies other than charities, supplies of property must be made for consideration that exceeds direct cost; must be for consideration in excess of \$5.00 or at least one sales person must be an employee; and if the supply is made in the course of a fundraising activity, supplies of the property must be made as part of that activity for greater than 15.5 weeks in a 12-month period. Supplies of services acquired for resupply must exceed direct cost, and if such services or any other services are supplied in the course of a fundraising activity, supplies of the service must be made as part of that activity for greater than 15.5 weeks in a 12-month period.

Parts V.1 and VI also provide exemption for supplies of admissions if certain conditions are met. Again, whether or not admission to a particular event will be caught by the exempting provisions is largely within the control of the supplier.

Paragraph 1(e) of Part V.1 and Section 9 of Part VI provide that the supply of an admission to a place of amusement will be exempt if the maximum consideration for such admission does not exceed \$ 1.00. For the purpose of these sections, the phrase “place of amusement” is defined quite broadly¹⁶ and includes most places and events where any type of amusement or recreation is provided. In order to cause otherwise exempt admissions to be taxable, and assuming that no other exempting provisions apply, the supplier simply needs to set the consideration for admission in excess of \$ 1.00. The benefit of this action goes beyond the input tax credit entitlement. It is likely that the supplier is not interested in holding up the box office with its tellers making change for admissions of \$ 1.05 plus GST/HST. Therefore, if it were to set the price of admission at \$ 2.00 inclusive of GST/HST, for example, it would keep the lines moving, achieve full GST/HST recovery, and increase its revenue generation.

Section 11 of Part VI exempts the supply of a right to be a spectator at performances, athletic events, and competitive events if the following conditions are met: 90% of the participants in the event receive no remuneration (other than reasonable amounts as prizes, gifts or

¹⁵ As defined by subsection 123(1) of the *Excise Tax Act*.

¹⁶ Subsection 123(1)

compensation for travel and other related expenses); and if there will be any participants that will receive remuneration, they are not featured in any advertising for the performance or event. Also, explicitly excluded from this exemption are supplies of the right to be a spectator at a competitive event in which cash prizes are awarded and in which any competitor is a professional participant. While the professional status of the participants may be beyond the control of the public service body hosting such an event, the payment of the participants and the event advertising is not. As such, if the supplier were to pay at least one of the participants an amount other than the reasonable amounts referred to in the legislation (a participation fee, for example) and to advertise that person's participation, the otherwise exempt supplies of these admissions could become taxable. Considering that the CRA generally accepts that the delivery of a message in any manner constitutes advertising, this should be relatively easy to achieve.

Sections 17 and 18 of Part VI are among the most reasonable of the exempting provisions found within the *Excise Tax Act* in that they provide the opportunity to opt out of exemption: as simple as that. Unfortunately, the ability to opt out of treating supplies of memberships as exempt supplies is not extended to charities.

Section 17 provides that the supply of a membership in a public sector body (other than a dining, recreational or sporting club or registered party) is exempt if the benefits to each member are limited to:

- a) an indirect benefit that is intended to accrue to all members collectively;
- b) the right to receive services supplied by the body that are in the nature of investigating, conciliating or settling complaints or disputes involving members;
- c) the right to vote at or participate in meetings;
- d) the right to receive or acquire property or services supplied to the member for consideration that is not part of the consideration for the membership and that is equal to the fair market value of the property or services at the time the supply is made;
- e) the right to receive a discount on the value of the consideration for a supply to be made by the body where the total value of all such discounts to which a member is entitled by reason of the membership is insignificant in relation to the consideration for the membership; or
- f) the right to receive periodic newsletters, reports or publications;
 - (i) the value of which is insignificant in relation to the consideration for the membership; or
 - (ii) that provide information on the activities of the body or its financial status, other than newsletters, reports or publications the value of which is significant in relation to the consideration for the membership and for which a fee is ordinarily charged by the body to non-members.

Section 18 is similar in that it provides exemption for memberships in professional organizations where membership in the organization is required to maintain a professional status recognized by statute.

Traditionally, whether public service bodies have opted to make supplies of their memberships taxable has largely been determined by whether or not the members are entitled to claim input tax credits in respect of the supply. For example, non-profit organizations that make supplies of memberships to individuals and professional organizations whose members are engaged in exempt activities, such as physicians typically do not elect to make supplies of their memberships taxable, whereas organizations whose members are entitled to claim input tax credits typically do.

The benefit of taxing a membership in a professional organization where members can claim input tax credits is clear. However, whether there is a benefit to taxing memberships where members cannot recover the tax should be re-evaluated. Consider that many non-profit organizations that offer memberships do not receive any government funding, will therefore not be entitled to a section 259 rebate, and will consequently carry the full burden of the GST/HST that they incur to operate. Where such an organization elects to make its memberships taxable, it would be entitled to recover much if not all of the GST/HST it incurs by way of input tax credit. Additionally, as discussed earlier, opposition to paying the tax has likely decreased to the point where the application of GST/HST to the membership fees may not even be noticed or questioned by the members, especially if membership fees are set at a GST/HST inclusive amount.

In order to make the election, the organization must complete either Form GST 23 in respect of general memberships or Form GST 24 in respect of professional memberships. While these forms must be completed to cause the otherwise exempt supplies of membership to be taxable, it is not required that they be submitted to the CRA. Rather the completed election forms must be retained in the records of the organization. If making the election will require the organization to register for GST/HST, it should ensure that its registration date is the same as the effective date of the election, in order to maximize input tax credit entitlement.

In the event, that a public sector body wishes to pursue any of the foregoing opportunities, it should take all of the necessary steps to ensure that it fully escapes the exempting provisions. In the worst case scenario, a public service body may believe its supplies to be taxable, begin to charge GST/HST and claim input tax credits only to find out on audit that it was not in fact making taxable supplies. When stepping outside the box like this, it is always prudent to confirm your position through a GST/HST Application Ruling.

Restructuring of Certain Research Activities Undertaken by Hospital Authorities and Universities

Supplies of research and other laboratory services made by hospital authorities, universities and other public institutions are generally exempt of GST/HST since they are not specifically excluded from the exemption provided by Section 2 of Part VI of Schedule V. As they are not excluded, there is no opportunity for such supplies made by such entities to escape exemption. Unlike the memberships discussed previously, no such election exists for supplies of research and other laboratory services made by public institutions. This, in the author's opinion, is an

absolute shame because it distorts basic value-added-tax principles and causes additional complexity for public institutions that make such supplies.

The distortion of value added tax principles lies in the fact that much of the research and laboratory services supplied by public institutions are supplied to for-profit commercial entities such as pharmaceutical, medical device, and software companies. However, regardless of the recipient, the supplies remain exempt. As the supplier is not entitled to recover GST/HST incurred, the consideration payable for the supplies it makes, in theory, includes an amount of GST/HST that may not be recovered by the recipient. This very fact undermines a fundamental tenet of the GST/HST: that registrants engaged fully in commercial activities should not bear any tax on direct inputs.

This burden is compounded by the CRA's recent position that supplies of research and laboratory services to third parties may not be considered to be activities undertaken in the operation of a public hospital¹⁷ and therefore any GST/HST incurred on related inputs is limited to the rebate that a hospital authority is entitled to in its capacity as a charity. Since the rebate for a university is calculated in the same manner as a rebate for a hospital authority, the university's rebate would presumably also be restricted in respect of such inputs.

While section 2 of Part VI does not provide an opportunity for public institutions to cause these supplies to be taxable, this can be achieved if a public institution were to supply such services through a related entity, such as a non profit organization, that is not a charity. Supplies made by such an entity would escape the narrow confines of Section 2 of Part VI and no other provision of Part VI would pull them back in. Thus, the not-for-profit research entity would achieve the benefits afforded to a person that exclusively makes taxable supplies; namely, the entitlement to full input tax credits.

Under this model, a hospital authority or university would continue to undertake all of its own research, related directly to the care of its patients, for which it would presumably be entitled to claim rebates equal to the appropriate specified percentage and the specified provincial percentage. However, any commercial research would be conducted by the related entity: input tax credits would be claimed and GST/HST would be charged to resident recipients. Supplies to non-residents would be zero-rated unless the applicable zero-rating exclusions apply. As such, commercial-type research currently undertaken by hospitals and universities would become true commercial activities if supplied by a related entity.

For a hospital or university that does a significant amount of commercial research, there appears to be little down side to operating under the proposed model. One of the benefits of conducting research directly through a hospital or university is that on occasion these institutes receive generous donations that the benefactors dictate must be put toward certain research activities. However, it is unlikely that any benefactor would direct his or her subsidies toward commercial research. Accordingly, the proposed model should not negatively impact donations made to hospitals and universities.

¹⁷ GST/HST Policy Statement P-245 - Determination of "...activities engaged in by the person in the course of operating a public hospital" for purposes of the 83% public service body rebate for hospital authorities.

Another consideration for a hospital authority is that if it can jettison its commercial research activities into a separate entity, it may relieve itself from being required to allocate its rebates between inputs acquired in the course of operating a public hospital and inputs acquired for other purposes. Subsection 259(14) provides that if substantially all (e.g., $\geq 90\%$) of the tax included in a hospital authority's "non-creditable tax charged" is tax incurred by it in its capacity as a hospital authority, then all of its non-creditable tax charged is considered to have been incurred by the person acting in that capacity. Thus, since Policy Statement P-245 states that the CRA does not consider commercial research to be undertaken in a person's capacity as a public hospital, removing any GST/HST from the denominator of this calculation would be extremely beneficial if it results in a hospital not having to allocate its rebate entitlement.

Although no deeming provision similar to 259 (14) exists for universities, the proposed model is equally beneficial to universities as it is to hospitals. While a university may still be required to allocate its rebate entitlement between various activities, the commercial research undertaken by the related entity will not bear any unrecoverable tax.

Ultimately, whether the proposed model is reasonable for a hospital or university to adopt will depend upon a number of factors, including the degree to which the institution undertakes commercial research and the amount of GST/HST incurred in such endeavors; the ease with which a hospital or charity can segregate its own research from commercial research; whether the creation of a subsidiary and undertaking of commercial research would contradict the institution's charitable objectives; whether this model would contravene any regulations under which the organization operates, the impact on the Scientific Research and Experimental Development entitlements of the organization's clients; and the willingness of the organization's administration and board of directors to accept the idea. Additionally, it is assumed that any organization adopting this model would be able to support that is had done so for legitimate business purposes.

Provincial Sales Tax Issues

Becoming Eligible for an ORST Rebate on Real Property Contracts

Section 14 of Regulation 1013 to the Ontario *Retail Sales Tax Act* provides a rebate for the governing body of a religious, charitable, or benevolent organization, where tangible personal property is incorporated into a building or structure owned or leased (for a period of at least 20 years) by the organization, subject to a number of exclusions, including that which prohibits the rebate in respect of certain types of buildings. The purpose of this section of the paper is not to discuss the technical nuances of what precise expenses qualify for the rebate and exactly what is meant by the phrase, "does not apply with respect to a building or structure," although that would be an interesting discussion. Neither will it discuss the Ontario Ministry of Revenue's current position on whether universities, schools, and hospitals are precluded from claiming

this rebate based on the findings of the Court of Appeal in the Ministry of Finance vs. The University of Waterloo¹⁸; although that too would be an interesting discussion.

Rather, this section will examine the general entitlement to the rebate as established by subsection 14(1). At first pass, it appears that rebate entitlement is quite broadly afforded to the governing body of any religious, charitable, or benevolent organization. However, upon further examination, it becomes clear that in order to qualify for this rebate, a religious, charitable, or benevolent organization must be a registered charity under the *Income Tax Act*,¹⁹ rendering the inclusion of religious and benevolent organizations in subsection 14(1) somewhat meaningless.

If a religious, benevolent, or other organization that provides charitable-type benefits to the public is not registered as a charity under the *Income Tax Act* and it will undertake a significant real properly development, it may wish to consider seeking charitable status. As a rough and ready calculation, the benefit of becoming a charity and therefore securing an entitlement to this rebate is between 3 and 3.4 percent of eligible expenditures. In other words between \$30,000 and \$ 34,000 for every million dollars invested.

Although registering as a charity is a time consuming process and will involve incurring some professional fees, if the project is significant enough, the benefit of the rebate may significantly outweigh the time and financial investments required. It should be noted that it is not necessary for an organization to be a registered charity at the commencement of a project, but rather it must be a charity when it applies for the rebate, which is generally four years from the last payment under the agreement for the incorporation of the tangible personal property into a building or structure. Another beneficial spin-off of becoming a registered charity is that the organization would be able to issue charitable receipts for donations, which could result in additional revenues for the organization.

Before investing too much time or money into the application to become a registered charity, an organization should analyze its likelihood of being granted registered status. The following outlines the process and criteria for registration.²⁰

Registration can only be granted if:

- the applicant's purposes and activities fall within the legal concept of charity as recognized by the courts; and
- the organization meets the other requirements of the *Income Tax Act*, including the obligations of a registered charity.

¹⁸ MF (ON) v The University of Waterloo [2003] 5006 ETC.

¹⁹ Subsection 14(2.1) of Regulation 1013 to the *Retail Sales Tax Act*.

²⁰ Information provided by the CRA in its publications, "Registering as a Charity for Income Tax Purposes" and "Charitable Work and Ethnocultural Groups - Information on Registering as a Charity - January 2008"

In order to be registered, the organization must be established and operated for public purposes, and it must devote its resources to charitable activities. The charity must be resident in Canada and cannot use its income to benefit its members.

Public Benefit Test

A charity must meet a public benefit test by showing that:

- its activities and purposes provide a tangible benefit to the public;
- those people that are eligible for benefits are either the public as a whole, or a significant section of it; and
- the charity's activities must be legal and must not be contrary to public policy.

Charitable purposes

For an organization to be registered all of its activities must fall within one or more of the following four categories:

- the relief of poverty;
- the advancement of education;
- the advancement of religion; and
- certain other purposes that benefit the community in a way the courts have said are charitable.

The application for registration must show the way the organization will meet each of its charitable purposes.

Obligations of a registered charity

A registered charity must:

- devote its resources to charity;
- continue to meet the other requirements of registration; and
- file Form T3010 (Registered Charity Information Return).

If these obligations are not met, the charity may lose registered status.

Other considerations

Every registered charity must be legally established by a governing document that legally establishes a charity and that identifies the objects or purposes for which the organization is established, as well as provide information on the organization's corporate structure and internal procedures. There are certain minimum requirements for trust documents and constitutions.

An application to register as a charity under the *Income Tax Act* is made by completing form T2050. The application must include:

- a statement of the organization's activities;

- an explanation of how the organization will make decisions;
- an estimate of the organization's income and expenses; and
- a governing document that describes the organization's purposes (also called objects). A governing document is a deed of trust, a constitution, or articles of incorporation.

In addition to the ORST rebate entitlement that may accompany the realization of charitable status, a non-profit organization that was not entitled to a GST/HST rebate would generally become entitled to recover 50% of the GST/HST it incurs.

BCSST Rebate for Charity Funded Purchases of Medical Equipment

The final opportunity to be examined is one that relates to the British Columbia Social Service Tax rebate for charity-funded purchases of medical equipment, announced in the 2007 British Columbia Budget. As a high level overview, a charity or member of the British Columbia Association of Health-Care Auxiliaries (BCAHA) may claim a rebate of BCSST where it either purchases qualifying medical equipment to be used by a health facility, such as a hospital, to treat or diagnose patient's ailments, or donates funds to a health facility for the purpose of its purchase of such equipment.

This rebate opportunity begins to approach the comparatively generous Retail Sales Tax exemption afforded to public hospitals in Ontario. However, without proper planning, potential rebate opportunities may be lost. For example, a hospital that is a charity is not eligible for this rebate if it uses its own funds to purchase qualifying equipment. As such, a hospital should ensure that to whatever extent possible, it uses funds donated by other charities or BCAHA members to purchase medical equipment and that it uses its own generated funds to support expenses that don't have rebate potential.

What is curious about this rebate opportunity is that it is similar to the flow-through input tax credit mechanism for GST/HST in some respects. Where a health facility purchases the equipment itself and pays the tax, it is not the person who pays the tax that is entitled to the tax recovery, but an unrelated third party. In this instance, it is advisable that prior to providing the donating charity or BCAHA member with the documentation necessary to file a rebate, the health facility request that the charity include the rebate amount in a future donation or receive assurance that the charity or BCAHA member flow the rebate through to the health facility. The donating entity would presumably not object to this since not flowing the rebate through to the health facility in effect reduces the amount that the donating entity had earmarked for donation.

In closing, the opportunities for public service bodies to maximize their GST/HST recoveries are abundant. While opportunities to realize provincial sales tax benefits are fewer, they do exist and can be quite beneficial with the proper structuring. The degree to which a particular public service body can turn these opportunities to its advantage will depend on a number of factors, including the type of entity it is; the specific nature of its activities; and its willingness to move beyond the status quo.