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Reserves and net asset accumulation

A governance guide for Ontario health regulatory colleges

Managing the risk of a profit purpose under the Income Tax Act

Executive summary

A college should be able to explain why it holds accumulated funds, how much it needs, and when those funds are expected to support public protection. A reserve policy helps establish that explanation, but labels alone cannot establish tax compliance.

This guide is for Councils, finance committees and senior leaders of regulatory colleges relying on paragraph 149(1)(l) of the *Income Tax Act* (ITA), who are developing or reviewing a reserve and net asset policy. [1]

What the Council needs to know

- Base reserves on regulatory needs. Reserve amounts and their intended uses should reflect the college's statutory duties, foreseeable financial risks and need to maintain essential regulatory services during unexpected events. [3]
- The Income Tax Act does not prescribe a reserve level. Maintain a reserve proportionate to the college's obligations and reasonably foreseeable risks, with its size supported by documented evidence. [1, 2]
- Designating funds as a reserve does not, by itself, establish that they are held for a not-for-profit purpose. The rationale, amount and actual use of the funds matter. [2]
- Support reserve amounts with cash-flow forecasts, risk estimates, project budgets and clear review dates.

Recommended Council action

Approve a policy with justified reserve ranges, defined spending authority and an annual assessment of the total balance. Require an action plan whenever funds materially exceed documented needs or when a reserve's purpose no longer exists.

Scope: This is a governance guide, not a determination of any college's tax status. College-specific tax, legal and accounting advice should inform adoption and significant changes.

Set a defensible reserve framework

Maintain the purpose in practice

Paragraph 149(1)(l) requires qualifying organizations to be organized and operated for purposes other than profit. For Ontario health regulatory colleges, the statutory public-protection mandate establishes the organizational purpose. Colleges should focus on continuing to operate for that purpose, including how funds are accumulated and used. The Act also prohibits income from being payable to, or otherwise available for, members' personal benefit. This restriction remains relevant to reserve decisions. [1, 3]

Reserve balances should reflect the college's reasonably anticipated regulatory needs. Accumulating funds beyond those needs may suggest a profit purpose. Council should be able to explain the amount held, its intended use and the expected timing of that use. [2]

Connect reserves to planning and budgeting

Strategic planning, annual operating budgets, annual dues and reserve planning are interconnected. Reserve decisions explain which needs will be met from funds already accumulated and which require further contributions. As plans and circumstances change, reassess the amounts currently held, future needs and the annual dues required.

Where existing reserves already meet documented needs, Council should require a specific justification for budgeting further surpluses and reconsider fee levels if further accumulation is not justified.

Maintain sufficient operating liquidity

The college should maintain sufficient readily available funds to meet its financial obligations and continue fulfilling its statutory mandate during revenue shortfalls or unexpected events. In determining the amount needed, the Board should identify which functions must continue, the consequences of interrupting them, and how long the college may need to operate with reduced revenue or increased costs.

The Income Tax Act does not prescribe a reserve level. The appropriate amount depends on the college's circumstances, including its cash flow, operating needs and reasonably foreseeable risks. [1, 2]

Amounts designated as reserves are not necessarily available as cash, and an internally restricted reserve does not require a separate bank account or investment. Council should ensure sufficient cash and liquid investments are available when needed.

Put the policy into practice

1 Match reserves to regulatory needs

For each reserve, document:

- What it is intended to fund and how it supports the college's statutory responsibilities.
- The target amount or range, including the calculation, assumptions and supporting evidence.

The following are examples of common reserve categories. Use those that address the college's needs, and review them together to avoid setting aside money twice for the same risk.

Therapy and counselling

Support the program required by section 85.7 of the Health Professions Procedural Code. Estimate funding needs using applicable eligibility rules, limits, existing commitments and reasonable demand scenarios. The program obligation does not itself prescribe a particular accounting reserve balance. [3]

Complaints and regulatory proceedings

Provide for unusually complex investigations, discipline and fitness to practise proceedings, or an unusually large number of cases, including related legal costs. Base the range on current and anticipated cases, past variations in costs and the potential for unusually expensive proceedings. Do not include ordinary casework already funded in the operating budget.

General contingency

Cover significant operational disruptions, such as a cyber incident or an urgent premises issue. The reserve amount should reflect the college's exposure to significant disruptions, taking account of insurance coverage and other reserves. Review the amount annually and document the reasons for any change.

Fee stabilization

A fee stabilization reserve can help the college use accumulated surpluses to moderate future fee increases. Base the amount on financial forecasts showing when and how the funds may be needed. Explain how its purpose differs from other reserves, so the same costs are not provided for twice. Review the balance annually against the college's fee and spending plans.

Special projects and modernization

Set aside funds for identified or reasonably anticipated projects, such as registration improvements, public register accessibility or regulatory reporting systems. Document the expected purpose, estimated cost and likely timing. As plans develop, update the estimates and obtain Council approval before spending. Review the reserve annually, particularly where projects have been delayed or are no longer needed.

Equipment and other capital needs

This reserve supports the planned replacement or acquisition of assets needed for operations. Its amount should reflect anticipated costs and timing, with periodic review as needs change. Coordinate it with any special projects reserve to avoid providing for the same expenditure twice.

Funding decisions for planned projects and purchases should take account of existing reserves. Any additional amounts collected through membership dues should be justified by reasonably anticipated needs beyond those already funded.

Evidence that strengthens the policy

Retain forecasts and project plans with the Council record to substantiate the purpose, amount and expected timing of each reserve. Simply naming a reserve does not justify continued accumulation. Without a documented estimate of need and a credible timetable for use, the college may struggle to demonstrate why it continues to hold the funds. If a project is delayed or cancelled, Council should promptly reassess whether the reserve remains justified and document its decision."

2 Build accountability into the policy

For each reserve, document:

- When funds are expected to be used, who can authorize spending and how the reserve will be replenished.
- When the reserve will be reviewed and what would prompt changes to its amount or intended use.

Annual review and reporting

Management should report opening balances, additions, expenditures, transfers and closing balances for each reserve. Include updated forecasts, the combined target range, available liquidity and explanations for variances. Council, or a committee assigned that responsibility, should scrutinize the assumptions.

Authority to change how reserve funds may be used

Council may approve a change to a reserve's purpose or release some or all of the amount for other uses, consistent with the college's policies and existing commitments. Record the decision, its rationale, the effect on the original purpose and any plan to replenish the reserve in the minutes. The policy should identify who may authorize urgent spending from a reserve and when they must report that decision to Council.

When net assets exceed identified needs

Reassess a reserve when:

- Its balance significantly exceeds the amount justified by current needs.
- Its original purpose no longer applies.
- Updated forecasts change the amount needed or when it will be used.

Council should consider whether the college's total accumulated funds remain justified by current operations, reasonably foreseeable risks and planned projects. Moving amounts between reserves does not reduce total accumulated funds or explain why those funds are needed. [2]

Where funds exceed identified needs, it may be reasonable to budget for a planned deficit, using accumulated funds to cover part of the college's expenses. A fee freeze or reduction in future fees may support that plan. The budget should show how much will be used, over what period, and what resources will remain.

If spending has not occurred as planned, Council should understand why. Consider whether the need remains and whether costs and timing have changed. Avoid additional spending simply to reduce the balance without a clear objective approved by Council. If overall needs have changed, consider whether future membership dues should also change.

A note on refunding members' fees

Accumulated surplus is not available for distribution to members simply because it exceeds the college's needs. Distributing accumulated income for members' personal benefit is incompatible with the requirements for tax exemption under paragraph 149(1)(l) of the Income Tax Act. Calling the distribution a fee refund or credit does not change its substance. Before approving any proposed refund or credit, Council should obtain tax and legal advice confirming that it is a genuine fee adjustment rather than a distribution of accumulated income. [1]

Questions before approval

- Can the college explain why it needs the total accumulated funds as well as each individual reserve?
- Are the estimates current, supported and free from double counting?
- Do investments and their maturities support forecast spending needs?
- Do the minutes record the rationale, decisions and follow-up dates?

Sources and further reading

[1] Income Tax Act, paragraph 149(1)(l)

[2] CRA Interpretation Bulletin IT-496R, paragraphs 8 to 10
Archived guidance dated August 2, 2001; not binding law.

[3] Regulated Health Professions Act, 1991, Schedule 2, sections 3 and 85.7

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