

CRA Releases New Guidance on the Direct Cost GST/HST Exemption for Charities and Public Service Bodies

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Background

In August 2026, the Canada Revenue Agency (CRA) released [GST/HST Memorandum 5-1, Direct Cost Exemption](#) (Memorandum 5-1). The memorandum explains the CRA's interpretation of the “direct cost” definition in subsection 123(1) of the *Excise Tax Act (Canada)* (ETA) and the related exemptions in section 5.1 of Part V.1 and section 6 of Part VI of Schedule V to the ETA.

For the sector, the challenge is that cost recovery often looks different in practice than it does in a technical tax analysis. Charities and not-for-profits may intentionally subsidize some participants, charge different rates to different groups, bundle materials into program fees, or build modest administrative recovery into pricing. Memorandum 5-1 is therefore a useful reminder that organizations should test each arrangement against the specific direct cost rules rather than relying on the broader commercial understanding of “breaking even.”

Key Takeaways

Overall, the direct cost exemption can prevent unrecoverable GST/HST from adding to the cost of goods and services sold without a profit margin. That said, the exemption is narrower than a general “cost recovery” rule. The legal test turns on the nature of the supply, how the acquired property or service is used, the components included in direct cost, and whether the amount charged is the supplier's usual charge.

This will be particularly relevant for charities and not-for-profit organizations that frequently purchase goods or services and resell them to students, members, beneficiaries, or program participants at or near cost. Examples may include universities, charitable organizations, professional associations, and other non-profit organizations.

Charities and not-for-profit organizations should review cost-recovery arrangements, pricing policies and supporting records before treating a supply as exempt. Specifically, it will be important to:

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- determine whether the organization is selling tangible property or a purchased service, or instead charging for access, participation, membership, licensing, or another non-qualifying supply;
- confirm that amounts treated as exempt do not include overhead, employee time, administrative costs, or mark-ups beyond permitted direct cost;
- keep written pricing policies showing the normal charge for each class of recipient, including subsidized pricing or ability-to-pay categories;
- make sure accounting systems distinguish taxable, exempt, and zero-rated supplies correctly; and
- retain supplier invoices, tax calculations, pricing approvals, and records showing how direct cost was determined.

If a fee includes materials plus program access, training, events, memberships, or participation rights, the GST/HST analysis may be more complex.

The Direct Cost Exemption

The direct cost exemption may apply when a charity or public service body (PSB), other than a municipality, sells tangible personal property or a service at a price intended only to recover its purchase cost. At a high level, the following conditions must be satisfied:

- The supplier is a charity or PSB, other than a municipality, and makes the supply by way of sale.
- The supply is tangible personal property (other than capital property or designated municipal property) or a service purchased for resale.
- The total charge is the supplier's "usual charge" for that supply to that class of recipient.
- The total charge does not exceed the "direct cost" of the supply.

For property or a service purchased for resale, direct cost generally includes the consideration paid or payable to acquire the property or service, including applicable GST/HST and certain other taxes, duties and fees. For tangible personal property produced for sale, direct cost may also include qualifying articles and materials incorporated into – or consumed or expended directly in – manufacturing, producing, processing or packaging the property.

CRA Guidance in Memorandum 5-1

Memorandum 5-1 provides useful guidance on the scope and limits of the exemption. In particular:

- Direct cost does not include administrative or overhead expenses, employee salaries or the cost of services acquired as inputs into another supply. An amount added to recover those costs may therefore cause the charge to exceed direct cost.

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- The supply must be made by way of sale. A lease, licence or similar arrangement does not qualify.
- The exemption does not apply to capital property, designated municipal property in specified circumstances, real property, or intangible personal property, including admissions and other participation rights.
- The “usual charge” may vary based on volume, the type of recipient, or the recipient's ability to pay. A properly established pricing structure may therefore support an exempt direct-cost sale to one class of recipients even where another class is charged a mark-up.
- The exemption does not apply where property or a service is normally sold above direct cost, but excess inventory is later sold at or below cost, because the reduced amount is not the usual charge.

If you have any questions about the application of GST/HST with respect to charities and not-for-profits, please contact Bobby Solhi, Natasha Smith, or any member of the Cassels [Tax & Trusts Group](#) and [Charity & Not-for-Profit Group](#).

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