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# CCRA shuts down charitable donation tax shelters

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# CCRA shuts down charitable donation tax shelters

By Robert Hayhoe

On Dec. 5, 2003, at 6:00 p.m., the Federal Department of Finance released draft legislation (effective immediately upon release) designed to eliminate the use of charitable donations as a tax shelter tool.

This Finance release followed closely after a Nov. 25, 2003, release by the Canada Customs and Revenue Agency (CCRA), which implied that, even without a legislative change, the CCRA would be attacking these structures aggressively.

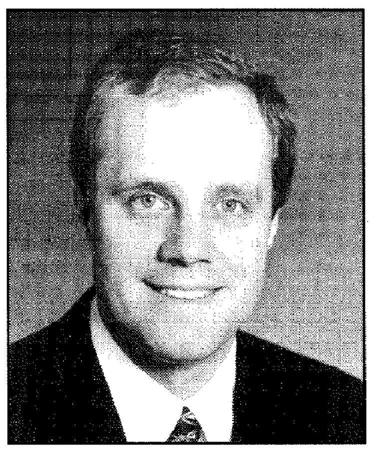
The draft legislation was designed to address two basic shelter programs.

The first could be characterized as "buy low — donate high." It involved programs whereby donors could purchase goods (artwork, basic foodstuffs and medical supplies were popular) from fundraising consultants at wholesale or even fire sale prices.

These goods could then be donated to particular charities, which would issue donation receipts at retail value (backed by professional valuations arranged by the fundraising consultants).

The difference between the wholesale and retail values would be large enough to ensure that on an after-tax basis the gift would be profitable, even after taking into account the tax on the resulting capital gain.

Although the CCRA had attempted on a number of occasions to challenge profitable donations as not involving real gifts, the courts have held consistently that a profitable donation was still a gift.



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While the CCRA has been successful in challenging some tax-shelter donations on the basis that the valuation of the donated gifts was inflated, this approach requires the CCRA to challenge each gift separately. Furthermore, many gifts were backed by very sophisticated valuation reports prepared by recognized independent experts.

Draft *Income Tax Act* subsection 248(35) will operate to prevent a donor from obtaining tax recognition for the portion of the value of a claimed non-cash donation that exceeds the donor's cost for the donated property unless the donated goods were obtained more than three years ago and with an intention other than to donate the goods.

Excluded from these new rules are donations of inventory, public securities, certified cultural property, ecological property, or real property in Canada and gifts at death.

The second type of shelter (known as a "leveraged donation shelter") involves a fundraiser arranging for a loan to a donor to enable the donor to make a charitable gift. At the same time, the donor invests an amount into a fund where it will grow during the loan term to reach an amount equal to the loan payable.

These programs did not give rise to a valuation issue and are recent enough that none of them has yet been considered by the courts.

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# *Some changes will have unintended consequences*

**TAX SHELTER**
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These leveraged donation shelters were addressed previously by the Department of Finance by proposed statutory changes. The new draft legislation follows this previous release and clarifies that, effective February 18, the amount of the gift is reduced by the amount of the sum borrowed to make the gift if the borrowing is limited recourse (defined broadly).

An amount owing is deemed by subsection 143.2(7) to be limited recourse unless there are bona fide written arrangements to repay the debt within 10 years and interest is paid annually within 60 days of the donor's year end at least at the CCRA's prescribed rate.

Proposed new subsection 248(37) contains a very broad anti-avoidance provision which is designed to allow CCRA to ignore transactions designed to inflate the cost of property which a donor intends to donate.

Charities, which have been involved with donation programs of the types described above, are at an increased risk of CCRA audit and should consider obtaining preventative legal advice in preparation for this possibility.

While individuals who have donated through these programs will also likely see their donations challenged, some may take comfort from the proposed changes — the existence of these amendments could be viewed as an admission that the previous rules did not prevent the operation of some donation programs.

From a taxpayer's perspective it may not be surprising that the Department of Finance announced the changes that it did.

However, some of the changes will have serious (presumably unintended) negative consequences for donors in other contexts.

For example, if an owner-manager owns shares in her company, these could become caught by the new rules if she exchanges her shares for shares of another class.

A passionate art collector who has some continuing intention to donate his collection before death could also be caught by the proposed rules.

While submissions are being made to the Department of Finance requesting that these situations be revisited, donors and advisors need to operate on the assumption that the proposed amendments will become law and will, in the ordinary course, do so with retroactive effect.

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