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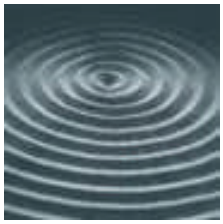

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TTC rejects retail value for charitable art donation

Robert B. Hayhoe

2004

TCC rejects retail value for charitable art donation

By Robert Hayhoe

In February, Associate Chief Justice D.G.H. Bowman of the Tax Court of Canada issued his decision in *Klotz v. The Queen*, [2004] T.C.J. No. 52, in which he rejected retail value as the appropriate fair market value in the context of art donation programs.

In 1999, Frank Klotz was a very successful derivatives trader. Like many other successful professionals, he was approached by his financial advisor with a charitable donation program proposal (this one called "Art for Education") that he purchase works of art (in this case fine art prints) at wholesale (in this case about $300 per print) from a promoter (here Curated Prints Ltd.) with an associated retail valuation report opining that each print was worth $1,000.

The promoter would then arrange for him to donate the art to a qualified donee (here Florida State University), which would issue him an official donation receipt for $1,000 per print. He could then claim a charitable donation tax credit worth approximately $450 per print in tax savings.

Klotz bought 250 prints for just over $75,000, then donated them at a claimed value of just over $250,000. The Canada Customs and Revenue Agency (CCRA) assessed Klotz on the basis that the prints given had a value of $300 each, the amount paid by Klotz. The CCRA also took the position that the prints were not personal use property. This was relevant because gains on personal use property worth

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less than $1,000 are not taxable, while gains on other capital property are taxable.

The court rejected the Crown's argument on personal use property, finding that one way that an individual can "use" property is to give it away (the Crown had argued that because the prints had never been hung on the wall by Klotz, there had been no "personal *use*").

However, the court accepted the Crown's valuation approach. Klotz had relied upon a valuation prepared by the promoter. This valuation was prepared on the basis that the best comparable market prices were retail prices in New York City galleries and dealer catalogue prices for similar prints by the same or similar artists and upon dealer catalogue prices.

The court began its analysis of valuation by outlining in some detail the factual background of the purchase of the print by the promoter's representative (all purchased for less than $50 each and some purchased for as little as $5). The court then pointed out various flaws in the appraisal (including the curious observation that virtually all of the donated prints were valued at $1,000 despite being different works by a number of different artists).

However, Justice Bowman's more fundamental objection was that the New York retail print market was, quite simply, the wrong comparable market.

The court's approach was to look for the best evidence of what a lot of 250 prints would sell for. The court found that Mr. Klotz's purchase price of $300 each was the best evidence (although Justice Bowman mooted that the promoter's purchase price of $50 per print was also arguable).

Justice Beaubier of the Tax Court (in *Malette v. The Queen*, [2003] T.C.J. No. 361) and Justice Murray Mogan of the Tax Court (in *Whent v. The Queen*, [1996] T.C.J. No. 731 – upheld by the Federal Court of Appeal) had previously rejected the application of any form of bulk discount in valuing donations of art.

Justice Bowman distinguished these decisions by characterizing his approach as a bulk valuation rather than a bulk discount.

'[W]e have not heard the last on art donation valuation. This decision will almost certainly be appealed.'

The court accepted the Crown's approach that the market for art for donations was so large that it formed its own distinct market for valuation purposes. This tax shelter market is a bulk market and bulk pricing should be applied.

This valuation theory was based upon a series of U.S. Tax Court cases which had come to a similar conclusion in examining similar programs which had been promoted to U.S. donors.

While the court acknowledged the existence of a specific U.S. tax regulation requiring that donation valuation be on the basis of the market in which the item is "most commonly sold to the public," Justice Bowman placed little importance on this distinction.

It will be interesting to see how the *Klotz* decision is applied as the Crown and the Tax Court work through the appeals arising from the thousands of assessments in which the Canada Revenue Agency has reassessed donations of art and other similar objects.

At one level, the *Klotz* decision could be read as a factual decision that the particular appraisal was not defensible. On the other hand, it could also be read for the proposition that mass-market charitable donation programs must, by definition be valued at the purchase price of the donated goods. In any event, we have not heard the last on art donation valuation.

This decision will almost certainly be appealed to the Federal Court of Appeal by Mr. Klotz (and the other Art for Education donors).

Robert Hayhoe practises charity tax law with Miller Thomson LLP in Toronto.