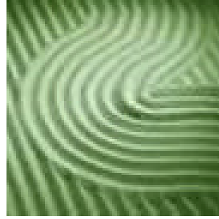
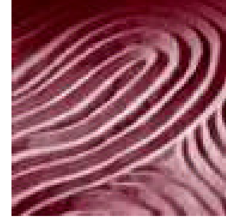
2500, 20 Queen St. West
Toronto, ON
Canada
M5H 3S1
Tel. 416.595.8500
Fax 416.595.8695
www.millerthomson.com





MILLER THOMSON LLP
Barristers & Solicitors, Patent & Trade-Mark Agents

TORONTO VANCOUVER CALGARY EDMONTON WATERLOO-WELLINGTON MARKHAM WHITEHORSE WASHINGTON, D.C.

Third Party Civil Penalties: What Every Charity and Gift Planner Should Know

By Susan Manwaring
2003

This article is provided as an information service only and is not meant as legal advice. Readers are cautioned not to act on the information provided without seeking specific legal advice with respect to their unique circumstances.
8 Miller Thomson LLP 1998-2003

THIRD PARTY CIVIL PENALTIES -

WHAT EVERY CHARITY AND GIFT PLANNER SHOULD KNOW

by Susan Manwaring[1]

Introduction

The Federal Government introduced changes in the year 2000 which created a new "mine field" to negotiate when embarking on an activity that involves giving tax advice or assisting with tax compliance matters including tax return preparation and filing. These rules can and do apply to gift planning and the professionals involved in the gift planning field.

Sections 163.2 of the *Income Tax Act* (Canada) (the "Act") and 285.1 of the *Excise Tax Act* (Canada) introduced civil penalties which can be assessed against third parties involved in preparing, selling or promoting "tax shelters" or tax-shelter like arrangements and against third parties involved in providing tax compliance related services to taxpayers. The former is referred to by the Canada Customs and Revenue Agency ("CCRA") as the Aplanner penalty@ and the latter is referred to as the Apreparer or filer penalty@. While aimed at traditional tax planners and tax filers, these third party civil penalties, as we will see, can apply equally to financial planners and any member of a charity giving advice to donors or potential donors as well as anyone involved in giving advice in connection with a planned charitable donation. The preparer penalty can equally apply to organizations involved in issuing charitable receipts.

---

[1] This paper was updated using a paper prepared with Bill Fowlis and Mark Chartrand of Miller Thomson LLP. Brennan Debbo assisted with the adaptation and I thank him for his assistance.

In this paper, we look briefly at the background to the legislation, summarize the details of the legislation as enacted, consider Information Circular IC-01-1 dated September 18, 2001 (the "Information Circular") and analyse steps advisors should take to prevent potential liability under these sections. The appendix includes case study examples.

Background

It is clear that the impetus for the legislation did not arise in the charitable sector. If asked to explain the impetus for this legislation, the Department of Finance ("Finance") could point to three independent committee reports that identified a need for some form of penalty to be applied to promoters of "tax offensive" schemes. In a 1996 report of the Auditor General of Canada[2], the Auditor General identified the difficulty the CCRA experienced in stopping leakage of taxes from the system through inappropriate use of tax shelters. The Auditor General identified the fact that promoters of abusive tax shelters bore virtually no risks under the Canadian tax system and highlighted that such penalties had existed in the United States as far back as 1982.

Subsequently, the House of Commons Standing Committee on Public Accounts endorsed this recommendation of the Auditor General[3] and the Technical Committee on Business Taxation (a committee made up of government and business representatives) recommended the imposition of broader civil penalties to defend the integrity of the Canadian tax system.[4]

---

[2] Report of the Auditor General of Canada (May 1996) (section 11)

[3] Report to the House of Commons, The Fourth Report of the Standing Committee on Public Accounts (February 10, 1997)

[4] Report of the Technical Committee on Business Taxation, December 1997 (Ottawa: Department of Finance)

It is therefore hardly surprising that Finance determined it was appropriate to respond to these recommendations by enacting the third party civil penalty proposals. Given the source of these recommendations, which included the tax community, one would expect Finance to respond in some way. What was surprising was the far-reaching scope of the third party liability imposed. These new provisions have resulted in changes in the manner in which advisors and planners provide advice. Further, some argue that the effect of the legislation is to turn advisors and planners into quasi-auditors working as unpaid conscripts for the CCRA.

The Legislation

As indicated above, the legislation enacts a Aplanner penalty@ in subsection 163.2(2) and a Apreparer penalty@ in subsection 163.2(4). There is substantial overlap between the two.

Although initially in commentary it was suggested by Finance that the planner penalty is to apply only to tax shelter or tax shelter-like investments[5], it clearly has application to all planning and valuation activity.

Similarly, although in government commentary it was suggested the preparer penalty was intended only for those advisors and return preparers who counsel, and assist others in, making false statements when filing their returns[6], the preparer penalty

---

[5] Third Party Civil Penalties, Dave Graham , Director Toronto Tax Services office, Presentation to CBAO, February 7, 2001

[6] Ibid

provisions are much more far-reaching and arguably require the advisor or preparer to verify or audit information provided by clients and others to protect themselves from potential liability.

Subsection 163.2 (2), the penalty for misrepresentations in tax planning arrangements (the Aplanner penalty@), provides that:

> AEvery person who makes or furnishes, participates in the making of or causes another person to make or furnish a statement that the person knows, or would reasonably be expected to know but for the circumstances amounting to culpable conduct, is a false statement that could be used by another person....... for a purpose of this Act, is liable to a penalty in respect of the false statement.@

Subsection 163.2(4), the penalty for participating in a misrepresentation (the Apreparer penalty@), provides that:

> AEvery person who makes, or participates in, assents to or acquiesces in the making of, a statement to, or by or on behalf of, another person ......that the person knows, or would reasonably be expected to know but for circumstances amounting to culpable conduct is a false statement, that could be used by or on behalf of the other person for a purpose of this Act, is liable to a penalty in respect of the false statement.@

It is helpful to look at the defined terms used in the provisions (which we have underlined) to understand the application of the penalties.

First, they apply to **persons** and, for the purposes of section 163.2 of the Act, a person is defined to include a partnership. In other words, they apply to all entities, individual or corporate, charities, for profit or not for profit, resident or non-resident.

They apply only if there is a **false statement** which is defined to Ainclude a statement that is misleading because of an omission from the statement@. In other words, false statements are defined to include things that are left unsaid.

Participate includes causing a subordinate to state or omit information or knowing of and not making a reasonable attempt to prevent the participation by a subordinate in a statement or omission of information.

Subordinate means in respect of a particular person, any other person over whose activities the person has direction, supervision or control whether or not the other person is an employee of the particular person or another person.

Culpable conduct is conduct which, if exhibited by the third party advisors, is unacceptable. It is defined to mean:

> A..conduct, whether an act or failure to act, that
>
> (a) is tantamount to intentional conduct
>
> (b) shows an indifference as to whether this Act is complied with; or
>
> (c) shows a wilful, reckless or wanton disregard of the law.@

The numerous other definitions contained in the section further illustrate the broad nature of these penalty provisions. **Valuation activity** is defined as anything done by a person in determining the value of a property or service. **Planning activity** is defined to include not only selling or promoting an arrangement, plan or scheme, but also to include organizing or creating, or assisting in the organization or creation of an arrangement, entity, plan or scheme. In other words, planning involves much more than participating in tax shelter activity (which as mentioned above, was the Auditor General's original area of concern).

Another remarkable aspect of these new penalties is the fact that the penalty may be assessed for a statement that a person knows, or would reasonably be expected to know, is a false statement that **could** be used by another person for a purpose of this Act. It is not necessary to know that the false statement will **in fact be used** to achieve a tax benefit, but rather if a person knows or ought to know that it **could be used** for such an objective, the penalty could apply. This is far-reaching in the extreme.

The definitions of **participate** and **subordinate** should insulate most in-house staff who rely on external tax advisors for planning, preparing donation receipts or filing tax forms and returns. Having said this, it is worth noting that **subordinate** is defined much more broadly than an employee, and includes a person who is directed, supervised **or** controlled by another. This definition could encompass certain situations where in-house tax staff instructs external tax advisors, especially in relation to communicating facts and giving instructions. In this way, in-house staff might be considered to **participate** in the making of a **false statement** by an external tax advisor that gives rise to one or both of the penalties.

One aspect of these provisions which is particularly relevant to gift planning is the application of these rules to "valuations". In the first instance, a valuation is a statement. Therefore, a valuation with which CCRA disagrees could be considered a "false statement" to which these rules apply. Given, however, the importance of valuations to tax planning generally, and to tax shelters or shelter-like investments, the section goes further and provides that valuations which are off by greater or lesser than a specific percentage result in the onus being on the advisor/planner to prove the valuation is correct. This will be discussed further below.

Section 163.2 also contains specific provisions providing that a valuation provided in the course of an **excluded activity** is a false statement against which a good faith defence is not available, raising the possibility of a penalty assessment. **Excluded activity** is defined to include tax shelter or tax shelter like investments. The 2003 Federal Budget introduced amendments to the definition of "tax shelter" with the result that plans or schemes that provide tax credits can be included as tax shelters. This change was introduced to ensure charitable giving arrangements could not escape these rules because receipts result in credits, not deductions.

There is potential for the imposition of very significant penalties under this new section. The amount of the **planner penalty** is the greater of

(a) $1,000; and

(b) the gross entitlements from planning or valuation activity.

The amount of the **preparer penalty** is the greater of

(a) $1,000; and

(b) the lesser of

(i) the subsection 163(2) penalty on the taxpayer (which can be up to 50% of the full amount of tax assessed); and

(ii) $100,000 plus the gross compensation in respect of the false statement.

Both **Agross entitlements@** and **Agross compensation@** are defined for the purpose of determining the penalties as the amount the particular person is entitled, either before or after that time, and either absolutely or contingently, to receive or obtain in respect of the activity or the statement. An amount for these purposes is considered to be the person's fees charged, profit realized, tax benefits obtained and/or any other potential income from being involved in making the **false statement**.

Onus of Proof

Under subsection 163(3) of the Act, the Minister has the onus of establishing on a balance of probabilities that the requisite elements of the penalty provision are met; that is that the person has participated in making or otherwise acquiescing to a false statement and that the statement could be used for the purposes of the Act. Once those elements are established, the onus will shift to the person who, to avoid application of the penalties, will be required to establish on a balance of probabilities either that he or she was not involved, that there was no culpable conduct, that he or

she acted in good faith or that the valuation was reasonable, or otherwise establish that the section should not apply. Again, if the stated value in a valuation is outside the prescribed value range, the reverse onus rule applies. The ranges have not been prescribed to date.

Defences

The legislation contains a number of provisions intended to assist in the defence of those assessed under section 163.2.

Subsection 163.2(9) provides that a person who provided clerical services (other than bookkeeping services) or secretarial services will not be considered to have made or to have participated in the making of such a statement by virtue of providing such services. The fact that such a provision is necessary illustrates the broad potential application of these penalty provisions.

One difficulty with this relieving provision is the multi-faceted duties of both managerial and non-managerial staff in both small and large organizations, some of whose duties are clerical or secretarial and some not.

Employees, (other than specified employees - i.e., employees who are shareholders holding greater than 10% of the shares of any class of **capital stock**, or who do not deal at arm=s length with **the person**), providing statements to a corporation which could be used by the corporation are also excluded by subsection 163.2(15) unless those statements are made in the course of an excluded activity (i.e. valuations for tax

shelters). Where the employee is exempted, such false statements of employees are attributed to the corporation for the purpose of applying the penalties.

The section contains Agood faith@ defence language to provide some assistance to the advisor. A person is not considered to have acted in circumstances amounting to culpable conduct in respect of the false statement if the advisor relied, in good faith, on information provided to the advisor, or because of such reliance, failed to verify, investigate or correct the information. This defence is not applicable to statements made in the course of an excluded activity (i.e. tax shelter arrangements).

One difficulty with this defence is that there is no guidance as to what circumstances must exist to establish reliance in good faith. The section as included is a form of defence which an advisor can raise and therefore the burden will be on the advisor to establish the good faith defence. This concept is not otherwise found in Canadian taxing statutes and therefore one must look at other common law to understand what has to be established to raise this defence successfully.

Generally, the advisor will have to establish an honesty of intention and belief together with a reasonable freedom from knowledge which ought to have lead the advisor to further inquiry.[7] It is therefore insufficient not to know there is further or additional information. The advisor must also be able to establish that another person in the same circumstances would not have made such an inquiry to determine whether there was further or additional information.

---

[7] *L'Heureux v. Civic Service Union* (1993), C.L.L.C. 16,035 (Alta. LRB)

Information Circular - The CCRA=s response

The "Information Circular 01-1 -Third Party Civil Penalties" dated as of September 18, 2001 outlines the CCRA's administrative position on the provisions.

Paragraphs 3 and 4 state CCRA's understanding of the purposes of the legislation:

> A3. The objective of the third-party civil penalties is to deter third parties from making false statements or omissions in relation to income tax or GST/HST matters. These penalties are directed at ensuring tax compliance by deterring behaviour that results in non-compliance.
>
> 4. The Canadian tax system has benefited from a co-operative relationship between professional advisors and Canada=s tax administration, the CCRA. Since that relationship is critically important to all Canadians, and to the continued health of our taxation system, *the CCRA is committed to apply the penalties, fairly, consistently and only when clearly justified. The CCRA recognizes that tax professionals have a responsibility to act in the best interests of their clients and this includes the right to minimize their tax liability within the law.*@ (emphasis added)

In the first draft Information Circular, CCRA took the unusual step of identifying numerous principles that had been formulated to ensure that the penalties were applied in a fair and reasonable way. These were dropped from the final form circular and replaced with general language that basically confirms that the rules are to apply to obvious false statements and defective tax shelter arrangements. CCRA states at paragraph 16 that the penalties are not intended to apply to:

- tax planning arrangements that comply with the law;
- honest mistakes or oversights;

- differences of interpretation or opinion where there is a *bona fide* uncertainty (e.g. the issue is not well settled in jurisprudence) ; and
- activities that are administratively acceptable to the CCRA.

What is interesting about the discussion in the Information Circular is that in it the CCRA appears to be acknowledging that the legislation has a potentially broad application. This is particularly reflected in paragraph 16 which lists situations where the legislation is not intended to apply. That list would not have to be included unless the CCRA was of the view that, based on the language of the statute, there was an argument that the legislation could apply.

There are a number of other interesting comments in the Information Circular relevant to the discussion here.

Paragraph 22 confirms that a **false statement** is an incorrect statement, and further that there is no requirement that the person had the intention to deceive when making the statement for the penalty to apply. The test is simply whether the person knew or should be reasonably expected to have known, but for circumstances amounting to culpable conduct, that the statement was a false statement that could be used for purposes of the ITA. A recent commentator noted that there is precedence and support for the argument that the term “false” is distinguishable from “incorrect.”[8] It was argued that false requires an element of intent while incorrect does not. Clearly, the CCRA does not agree with that distinction.

---

[8] Werner H.G. Heinrich, “The Tax Advisor: Civil Penalties and Criminal Sanctions”, Canadian Tax Foundation, 1999

Culpable conduct at paragraph 24 is referred to as conduct that is not simply an honest error of judgement or failure to exercise reasonable care (i.e. ordinary negligence). It refers to conduct (an act or failure to act) that is tantamount to intentional conduct, shows an indifference as to whether the ITA is complied with, or shows a wilful, reckless or wanton disregard of the law.

The Information Circular comments on the terms used in the definition of culpable conduct and their meanings. The expression **Atantamount to intentional conduct@** is said to mean conduct that is equal in effect to intentional conduct, i.e. a person=s conduct (an act or failure to act) shows the person must have intended to make (or participate in or assent to the making of) a false statement.

The expression Ashows an indifference as to whether this **Act** is complied with@ in the view of the CCRA refers to the passive aspect of culpable conduct. The reference is made to *Sirois (L.C.) V. Canada*[9] in which the Court, when considering Agross negligence@ for purposes of subsection 163(2), described the taxpayer=s behaviour as AHe buried his head in the sand@.

The Information Circular goes on to confirm that the indifference standard is considered to be much greater than that of ordinary negligence. It is “more or less” (how helpful is that?) equivalent to the standard used to measure the purposeful act of wilful, reckless or wanton disregard of the law.

The CCRA then describes its views as to the expression **Ashows a wilful, reckless or wanton disregard of the law**” as pointing to a situation where a reasonable, prudent

---

[9] *Sirois (L.C.) v. Canada* 96 DTC 3231 (TCC)

person should know that his or her actions would result in a false statement but purposely continues with the chosen course of action.

Whether or not these administrative positions and interpretations will be the same as those adopted by the Courts when interpreting the constituent elements of the definition of **Aculpable conduct@** will only be determined with time. It is difficult to ascertain any clear difference between gross negligence and culpable conduct although Finance incorporated the definition to help clarify when the penalties apply. Given that these provisions are quasi-criminal in nature, it is impossible to be certain how the Courts will interpret them and what tests will be established.

Professional Standards

Again, in quite an unusual step, the CCRA's Information Circular addressed concerns raised by professionals after having reviewed this new legislation. All professions raised a concern that the legislation creates situations where it will be impossible for them to perform their professional duties and comply. They have a duty to keep clients' affairs confidential. Given the nature of this legislation, the prospect of an assessment could result in the professional being required to breach client confidentiality which would be contrary to the standards of their profession and which could result in the professional being placed in a position of a conflict of interest.

By way of example, the Canadian Institute of Chartered Accountants ("CICA") raised a concern that the ANotice to Reader@ qualification used by accounting firms on non-audited financial statements would no longer be permissible because generally the notice confirms that the statements are made based on information provided by the

company and that information has not been independently verified by the accounting firm. The concern is that new section 163.2 requires this independent verification and simply by making this statement the accounting firm and the accountant could be liable. Increased review and verification by accountants and the firms to prepare such financial statements would result in a significant increase in costs to small and medium sized entities across the country. Charities certainly do not need this increased cost.

Paragraph 61 of the Information Circular confirms that Athe accountants= Notice to Reader communication@ is not considered to be an admission of indifference as to whether there is compliance with the ITA.

With respect to defences, at paragraph 62 of the Information Circular the CCRA confirms that in its view, having a contract in which the tax professional disclaims any liability for information or facts provided by the taxpayer does not absolve the professional from liability if the provisions for applying the penalties exist (i.e. the tax professional knew or ought to have known).

With respect to the issue of <u>who</u> should be assessed, the CCRA at paragraph 68 confirms it will look closely to identify the source of the false statement. CCRA intends to assess those persons directly involved in the making of the **false statement**. A charity and its officers will be exposed if they knew or should have known but for culpable conduct, about the **false statement**.

Further, CCRA states, an employee who makes a false statement which the employer knows nothing about, may be liable for these penalties.

In other words, no one is safe from these rules no matter what position is held.

The Application of the Civil Penalties to Charities

One way in which the civil penalties may affect charities is the concept of the "false statement". In a typical donation situation, there is a need for a valuation of the donated property. Naturally, the donor would like the value of the property to be as high as possible for purposes of the donation receipt. However, both the donor's planner and the advisors for the charity issuing the receipt need to be aware of the ways in which the civil penalties may apply.

Key to the imposition of the planners' penalty is the "false statement". This concept is certainly broad enough to embrace an incorrect valuation of property, either by the donor or by the charity. The Information Circular confirms this. Even beyond the application of the concept of the "false statement" to valuations, however, a special rule (subsection 163.2(10)) is provided for valuation activities.

SUBSECTION 163.2(10)

This rule applies to statements made as to the value of a property or a service (i.e. valuations, whether formal or informal) made by a person who gave their opinion on that value or by a person who used that value in the course of an excluded activity. If the value of the property or service is either higher or lower than a certain range from the fair market value of the property or service, that valuation will be deemed to be a false statement that the valuator or the person using the valuation would reasonably be expected to know was a false statement. At this time, the CCRA has not yet prescribed an upper or lower threshold range for this provision and thus it is inapplicable until such time as a range is prescribed. It should be remembered, however, that even if within

the range specified by the CCRA, a valuation can still be a false statement if the valuator knew or ought reasonably to have known that it was a false statement.

When the range is defined, which will occur after input from the tax and business community, the effect of this provision will be important for valuators on the donor side and the charity side. Under the general planner's penalty provision, not only is a false statement required, but the person using the false statement has to know or be reasonably expected to know that the statement was a false statement, before a penalty can be applied. The effect of subsection 163.2(10), when the range is decided upon by CCRA, will be to provide that, if the valuation is either a certain amount below or above the fair market value of the property or service (as the fair market value is determined by CCRA, or, if challenged, by the Courts), then the user or producer of the valuation is imputed with the knowledge required to impose the penalty, regardless of actual knowledge or the circumstances surrounding the valuation.

The application of this provision to the donation situation is twofold. First, the donor could be subject to the penalties if the valuation is inaccurate beyond the range specified by the CCRA, whether or not she or he created the valuation (as long as it was used by them in the course of an excluded activity) and second, the charity could be subject to the penalty if they acquiesce in the making of the valuation statement by the donor or the valuator. The acceptance of a donation and the issuance of a donation receipt to the donor in the amount of the inaccurate valuation could be construed as acquiescence to the making of the statement by the donor or the donor's valuator.

Until the range is decided on by CCRA and the above provision is applicable, an inaccurate valuation can still be a false statement and applicable to the regular penalty provisions. However, in this case the CCRA must be able to show actual knowledge

that the valuation was a false statement or must be able to show that the person making the statement should have reasonably been expected to know that it was false.

The relevance of the valuation provisions is especially important in the context of the recent amendments to the Act that introduced the concept of "eligible amount" and advantages to the way gifts are receipted by registered charities.

New ITA Amendments – Split - Receipting

At common law, a gift is a voluntary transfer of property. Therefore, when a gift of property was made to a charity, there could not be an advantage or consideration flowing to the donor on making the gift. For instance, if a donor donated real property subject to a mortgage and the mortgage was assumed by the charity, the value of the property could not be recognized as a gift with a charitable donation receipt as the advantage to the donor of the charity assuming the mortgage tainted the entire gift.

Pursuant to the amendments that introduced the concept of split-receipting, CCRA will recognise gifts as being charitable gifts where the donor receives some sort of advantage by the making of the gift (as in the example where the charity assumes the mortgage of the house). According to the amendments, CCRA will consider that the value of the gift for purposes of issuing a charitable donation receipt will be the fair market value of the gift less the fair market value of any advantage received or retained by the donor on the making of the gift. Thus, in the example with the house subject to the mortgage, the value of the charitable donation receipt issued will be the value of the house minus the current value of the mortgage assumed by the charity.

The effect of these amendments to the concept of gifts as they apply to the civil penalties, especially in light of the subsection 163.2(10) provision, when it becomes applicable, is to increase the number of valuations that will be necessary in many donation situations. Instead of simply valuing the property or service donated, valuations will be needed to determine the value of the advantage received or retained by the donor, in order to come up with the final charitable donation amount. If the valuations are not reasonable (in CCRA's view), the charity, donor and planners may all find themselves subject to these rules.

Another aspect of the civil penalties that could spell trouble for charities relying on a valuation of a donor is that the penalties can apply to false statements (i.e. valuations) that **could** be used for the purpose of the Act. Businesses and others obtain valuations for many different reasons (i.e. obtaining bank credit, matrimonial settlements, sales of businesses, insurance purposes, tax, estate and succession planning). Valuations obtained for one purpose may very well end up being used to support a request for a charitable donation, even though that was not originally intended. Blind reliance on an inaccurate valuation by the charity or by the donor even though the valuation was not originally intended to ever come before the CCRA, can lead to the charity or the donor or both being caught by these rules when there was clearly no intention or notion of achieving a tax benefit by way of the charitable donation receipt. This would be inappropriate and unreasonable. Nevertheless, the civil penalties do seem to go this far.

The Broad Concept of a "False Statement"

As indicated earlier in this paper, the concept of a false statement as defined by the legislation is very broad and can apply in a multitude of situations to a multitude of statements. Examples of the way a false statement can be considered to exist in

charitable giving situations usually involve the issuance of a charitable receipt when the charity knows or would reasonably be expected to know that a charitable receipt should not be issued.

Steps to Avoid Application

It is very important for all professionals to implement steps to ensure they avoid the broad reach of these new penalty provisions.

The best due diligence that can be implemented to minimize the risk is to document, document, document. It should be a priority to implement systems to ensure there is good documentation behind decisions that are made and steps that are taken. This is the case whether one is dealing with gift planning for the donor, the charity, an estate or preparing and filing a tax form or return or a charitable receipt.

The CCRA identifies the following items in paragraph 65 of the Information Circular under the heading "Guidance to Practitioners".

Penalty Prevention - Best Practices:

$ Record any information supplied by the client, donor, gift planner

$ Document any concerns about the truthfulness, accuracy of or inconsistency in the information supplied

$ Record questions asked about those concerns

$ Record the responses to all questions raised

$ Record any further discussion to clarify inconsistencies or contradictions

$ Document any research conducted and the results of such research

$ Record any assumptions made

$ Question the reasonableness of statements and assumptions

$ Record why the assumptions are reasonable

In all but one of those items, reference is made to documenting or recording the event. In other words, it is unlikely that your recollection will be sufficient when the questions are raised a few years after the fact. One needs only to have very little experience in Court before realizing that the most difficult cases to win are those which are brought forward when there is little documentation and credibility is an issue. It can be expected that this will be even more difficult when the Court is dealing with the application of a penalty provision.

Finally, CCRA recommends that if the person does not respond to the concerns you have, refuse the retainer. This can be very difficult if dealing with a donor with a large gift but remember, it is your livelihood and the charity's reputation that is at stake.

The due diligence steps will differ depending on the circumstances of the particular situation. For charities it will be important to implement systems that spot check the gift

planning activity. For independent gift planners, careful attention should be paid to documenting relationships with donors and their advisors and charitable entities.

These penalties will require education of gift planning officers so that such individuals appreciate the nature of the concern and the need for documentation at their end as well.

Consideration should be given to establishing systems that require every planning decision, valuation issue, and return filed to be reviewed by not less than two members of the gift planning group (one of whom must be a manager, director or higher on the organizational ladder depending on the organizational structure).

Boards of directors should include a regular item on meeting agendas whereby management reports on activities being pursued and steps being taken to ensure that all proper information is obtained and known to those involved.

For professionals involved in tax return preparation and filing, a standard checklist of information should be obtained and reviewed carefully. Follow up questions should be considered and asked where there are any ambiguities and uncertainties arising from the answers given.

Professionals should explain the nature of these penalties to their clients, to the donors and the duties they impose on the professional in the context of their relationship.

Donors and their advisors should acknowledge and be sympathetic to the precautions or concerns raised when negotiating a particular structure or gift.

Conclusion

The new penalties are onerous. They appear to force the professional to become a government watchdog for tax avoidance and evasion. We are not aware that any assessments for these penalties have been issued to date. The CCRA has stated in the Information Circular that the penalties are not to require action from the parties involved when appropriate tax planning is taking place.

However, there is rarely general agreement between the tax community and the CCRA as to what is Aappropriate@tax planning and what is evasive activity. The Supreme Court has repeatedly reaffirmed the principle that planning to minimize tax payable is legitimate and proper. There is however no clear indication that the CCRA has got that message to date.

The first chapter on the application of these new penalties has yet to be completed and we expect that there will be much discussion and possibly some amendment to the provisions with time. It is clearly recognized by the author that an appropriate third party civil penalty provision in the Act is a positive and constructive step to implement. That said, the penalties which apply should permit planners to properly function and pursue their clients' or organizations' affairs.

APPENDIX 1 – EXAMPLES

Some of these potential situations where the penalties could apply in the charitable giving field are examined below.

Example 1 – Deliberate over-valuation in a tax shelter-like arrangement

A promoter sells a tax shelter-like arrangement to individual taxpayers involving 10,000 pieces of art.

Each taxpayer acquires one piece of art for its fair market value of $100. The valuator is aware of this information but agrees to appraise each art piece at $1,000.

Concurrently, the promoter solicits a registered charity that agrees to accept the art as charitable donations and issue a charitable donation receipt in the amount of the appraised value ($1,000 per artwork). This charity immediately auctions off the art to the highest bidder and the price paid reflects the $100 value per piece.

A tax return preparer, who does not have any direct knowledge of the false statement, prepares the income tax return of his client, who had acquired and donated art making use of the above-mentioned arrangement.

The CCRA conducts a review of the client's return and determines that it contains a false statement (the overvaluation of the property donated).

Comments

The promoter organized an arrangement that he or she knew included a false statement (i.e. about the discrepancy between $100 value of the art and the issuance of $1,000 charitable donation receipts), so the CCRA would consider assessing the promoter with the "planner penalty".

The valuator has furnished false statements knowingly relating to the arrangement and is liable to the penalties unless he can prove the stated value was reasonable in the circumstances and that the statement was made in good faith.

If the charity knew, or would have reasonably been expected to know but for circumstances amounting to culpable conduct, that the valuations were incorrect, it would be liable for the penalties for issuing false receipts.

Although the tax return did not contain a false statement, the tax return preparer did not know of the false statement, nor would he reasonably be expected to know but for circumstances amounting to culpable conduct. As a result, the preparer would not be assessed a third-party civil penalty.

Note: This example is taken directly out of the Information Circular.

This example demonstrates how CCRA believes the rules will apply in that situation. Any gift plan which involves valuations can create this situation. Rule of thumb, if it looks too good to be true, it probably is! Valuations are difficult but generally the "reasonableness" test helps. If you conclude the basis is reasonable, and have no knowledge otherwise, it is probably defensible.

Example 2

In some instances, a business wants to make a donation of its inventory to a charity. Although the charity need not advise the business as to the tax implications of this donation, it must be aware of them so that it will be aware of a potential abuse of the taxing provisions by the business and will thus know not to issue a charitable donation receipt for the inventory. CCRA has issued a Policy Paper commenting on donations of inventory. In this Policy Paper, CCRA states that the charity has a responsibility to ensure that it has in fact and law received a gift. If the business donor receives a benefit from the donation in some other way, such as receiving free promotion or advertising, the charity must be able to place a value on this benefit so as to reduce the amount of the charitable donation receipt accordingly, pursuant to the split-receipting rules discussed above.

Example 3

A donor wishes to donate two free weeks use of her cottage to a charity auction. The charity must be aware that CCRA only considers a gift to have occurred if an interest in property is transferred. No interest in property is transferred in this instance. Thus, this type of donation would not be a gift for which a charitable donation receipt can be issued. Again, the issuance of a charitable donation receipt in this circumstance could be considered a false statement if the charity knew or would reasonably be expected to know that such a donation was not a gift, knowledge that it would be hard to deny given CCRA's explicit published policy in this regard.

Similarly, other donations of services or time cannot qualify as gifts for the purposes of issuing charitable donation receipts as they are not transfers of interests in property.

However, if someone performs services for a charity and is paid for those services, the return of the money to the charity can be recognised with a charitable donation receipt.

Example 4

In some instances, a donor will make a donation and ask the charity to put a specific name (not their own) on the charitable donation receipt. If the person providing the property being donated is in fact acting on behalf of the real donor, the charity may issue the charitable donation receipt in the name of that donor. However, the charity must satisfy itself that the donation is in fact being made on behalf of the person whose name is asked to appear on the charitable donation receipt. Failure to satisfy itself that this is the case or in circumstances where it is obvious that the name that is requested to appear on the charitable donation receipt is not the donor (i.e. a corporation donates money ostensibly on behalf of one of the shareholders but uses a cheque of the corporation), may lead to the issuance of a charitable donation receipt being considered a false statement.

Example 5

Donations of insurance policies whereby the charity is made the beneficiary of the policy may be considered gifts for which a charitable donation receipt can be issued if the charity is actually given ownership of the policy (even if the donor still pays the premiums). However, if the charity is not made the owner of the insurance policy, the gift does not qualify for a charitable donation receipt and the issuance of one could be considered a false statement.