The Tax Expenditure Program for Charitable Giving: Kicking a Gift Horse in the Teeth

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**KEYWORDS:** CHARITABLE DONATIONS ■ TAX SHELTERS ■ TAX AVOIDANCE ■ VALUATION ■ CHARITIES ■ TAX EXPENDITURES

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**INTRODUCTION**

Section 118.1 of the Income Tax Act¹ provides a two-tier tax credit for gifts made by individuals to registered charities. Section 110.1 provides comparable relief in the form of a taxable income deduction for gifts made by corporate taxpayers. At a general policy level, there is nothing especially unusual about these provisions. Tax recognition for charitable gifts, usually in the form of a taxable income deduction, is a standard feature of the income tax systems in member countries of the Organisation for Economic Co-operation and Development. Although it is argued in some of the literature that charitable gifts are properly deductible in computing

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¹ RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”). Unless otherwise stated, statutory references in this note are to the Act.
taxable income,\textsuperscript{2} it is probably accurate to say that the prevailing opinion rejects this characterization in favour of a characterization of tax relief as a tax expenditure: that is, the provision of tax relief is a subsidy program for registered charities delivered through the tax system. As many commentators have emphasized, tax relief in the form of a tax credit or a taxable income deduction in respect of the amount of charitable gifts is tantamount to a matching grant program.\textsuperscript{3} Tax relief lowers the cost of charitable giving to taxpayers at the specified rate, while the government provides a matching donation to the recipient charity equal to the tax revenue forgone because of the gift. The amount of the eligible gift determines the amount of the matching grant.

The tax expenditure program for charitable giving applies equally to cash and in-kind gifts of property. This result is realized through the statutory concept of eligible gifts, which refers to “the fair market value of a gift” made by the taxpayer\textsuperscript{4}—the obvious implication being that in-kind gifts are included.\textsuperscript{5} The rationale for the extension of tax relief to in-kind gifts seems simple enough. Forcing the realization of the accrued gain or loss on donated property and providing tax relief for the amount of a gift equal to the realized value ensures that an in-kind charitable gift is taxed consistently with a cash gift made to a registered charity out of the proceeds of sale. Consistency of tax treatment ensures that taxpayers and registered charities choose between cash and in-kind gifts on the basis of relevant non-tax considerations. This general result is modified for a narrow range of in-kind gifts of property (cultural property, ecologically sensitive land, and publicly traded securities) that are treated preferentially in an effort to encourage such gifts. Tax recognition of in-kind gifts generally is limited, however, to in-kind gifts of property. The Canada Customs and Revenue Agency (CCRA) has taken the position that in-kind gifts of services are not within the statutory concept of charitable gifts.\textsuperscript{6} This administrative position ensures consistency of tax treatment as between in-kind gifts of property and services, since tax recognition is effectively provided for the


\textsuperscript{4} Subsection 118.1(1), definition of “total charitable gifts” of an individual. See also subsection 110.1(1), definition of “charitable gifts” of a corporation.

\textsuperscript{5} The status of in-kind gifts of property as eligible charitable donations was considered in the early case law, and after some hesitation, the extension to such gifts was accepted. See Gaudin v. MNR, 55 DTC 385; (1955), 13 Tax ABC 199 (the sale of a house to a church for one-half of its value did not give rise to a gift); and Consolidated Truck Lines Ltd. v. MNR, 68 DTC 399; [1968] Tax ABC 472 (the value of a yacht donated to the University of Toronto was recognized as a gift).

latter through the forgone income that is equal to the value of the services and is not imputed to the donor.\(^7\)

Consistency of tax treatment of cash and in-kind gifts of property to registered charities depends critically on the integrity of the valuation of donated property. The absence of a market transaction provides an opportunity to inflate value in an attempt to inflate the amount of the matching grant to a registered charity. This incentive effect arises where, as is currently the case for cultural property,\(^8\) ecologically sensitive land,\(^9\) publicly traded securities,\(^10\) and indeed capital property generally,\(^11\) the tax payable on appreciation in value is less than the amount of tax relief provided in respect of the realized appreciation. In that case, excess relief can be used to reduce tax payable on other income of a donor. In the extreme, such relief provides a tax saving that eliminates any cost of giving to a donor, and charitable giving can become “profitable” to the donor on an after-tax basis.

The CCRA has attempted to address, with limited success, tax-driven overstatements of property value by challenging those valuations through the dispute resolution process. Where the volume of transactions is substantial, this approach—which amounts to an evidentiary contest between the expert valuers hired by the government on one side and the taxpayer on the other side (“duelling valuators”)—can be an enormous drain on scarce administrative and judicial resources. In an effort to save these resources, tax policy makers can use other approaches to constrain tax-driven valuations. These approaches can use proxies for valuation, or they can involve the explicit delegation of the valuation exercise to an independent authority. For example, when the CCRA found itself overwhelmed by valuation challenges with gifts of cultural property, where the incentive is greatest because of a zero capital gains tax rate on the donated property, the Department of Finance responded to the spectre of overstated valuations by designating the Canadian Cultural Property Export Review Board as the arbiter of valuations for charitable donation purposes.\(^12\)

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7 But see David G. Duff, “Charitable Contributions and the Personal Income Tax: Evaluating the Canadian Credit,” in *Between State and Market*, supra note 3, 407-56, at 410 (suggesting that tax assistance intended to encourage charitable gifts and subsidize charitable activities should be extended to gifts of services).

8 Subparagraph 39(1)(a)(i.1), which exempts from tax capital gains realized on the donation or sale of cultural property to an institution or public authority designated under section 32(2) of the Cultural Property Export and Import Act, RSC 1985, c. C-51, as amended.

9 Paragraph 38(a.2), which reduces the capital gains inclusion rate to one-quarter for ecological gifts.

10 Paragraph 38(a.1), which reduces the capital gains inclusion rate to one-quarter for gifts of various publicly traded securities.

11 Only one-half of capital gains are subject to tax, while the tax relief for charitable gifts is based on the full fair market value of the property donated.

12 Even so, as discussed in the cases considered in the next section, the valuations determined by the Canadian Cultural Property Export Review Board can substantially exceed the prices paid by a taxpayer in open-market purchases that are close in proximity to the time the cultural property is donated.
More recently, the increasing use by taxpayers of the $1,000 de minimis threshold for dispositions of personal-use property to eliminate gain on the gift of such property to registered charities prompted the Department of Finance to respond by introducing provisions that deny the availability of the threshold for gifts that are made as part of a marketed transaction. In the February 2003 budget, the Department of Finance followed this initiative with a requirement that certain “gifting arrangements” involving tax credits be registered as tax shelters with the CCRA.

These limited responses, in combination with direct challenges of property valuations, failed, however, to stop abuse of the tax recognition of in-kind charitable gifts. Indeed, promoters of charitable donation schemes and certain registered charities became ever more brazen in their “rip off” of the tax expenditure program for charitable gifts. The brazenness was reflected in the marketing of all kinds of “buy-low, donate-high” arrangements for in-kind gifts, as well as the development of “leveraged gifts” in which a donor borrows the funds used to make a cash gift and enters into a related arrangement that provides a benefit intended to reimburse the donor. The increased volume of these schemes finally forced the Department of Finance to respond on December 5, 2003 with the release of draft legislation that essentially limits the recognized value or amount of certain charitable gifts to the donor’s “economic cost” of the gift.

We argue in this brief note that the general thrust of the draft legislation is correct from a policy perspective. In fact, we cannot remember the last time that a legislative initiative intended to shut down a tax shelter was greeted so sympathetically in

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13 Subsection 46(5) and consequent amendments to subsections 46(1) and (2), introduced in the 2000 federal budget and enacted in SC 2001, c. 17, section 31, applicable February 27, 2000.

14 Amendments to section 237.1, introduced in the 2003 federal budget and enacted in SC 2003, c. 15, section 87, applicable after February 18, 2003. The 2003 federal budget also proposed that, in the case of charitable donation schemes involving limited-recourse debt, the amount of the gift would be reduced by such debt: Canada, Department of Finance, 2003 Budget, Budget Plan, February 18, 2003, 382. This amendment was not included in SC 2003, c. 15, although it is included in December 2003 draft legislation, infra note 17.

15 A third legislative amendment, the introduction of third-party civil penalties, has similarly had little, if any, effect. The “planner penalty” in subsection 163.2(2) may be levied against a scheme’s promoter, appraisers, advisers, charities, or other institutions if they knew, or would reasonably be expected to know but for circumstances amounting to culpable conduct, that the appraised value of property that is the subject of the scheme is too high. Subsection 163.2(2) was added by SC 2000, c. 19, section 50, applicable to statements made after June 29, 2000. In the fact sheet concerning charitable donations released on November 25, 2003 (infra note 26), the CCRA indicated that it would consider the imposition of third-party civil penalties in these cases, although we are not aware of any cases in which it has in fact done so.


the tax expenditure program for charitable giving. We make the obvious point that the targeted transactions are nothing more than an example of tax shelters generally, where the incentive to overstate value in an attempt to inflate the associated tax benefits has been constrained through at-risk and limited-recourse debt rules, which use a proxy value (that is, a taxpayer’s amount at risk) for the value of a tax-preferred asset that can be respected for income tax purposes. The extension of the same type of approach generally to both in-kind gifts of property and leveraged cash gifts was long overdue. We highlight, however, some areas of disagreement with the proposed legislation.

Our critical comments are not grounded in any way in a critique of the tax expenditure program for charitable donations generally. We take the continued existence of the program as a given and, in fact, believe that a legislative response is necessary to preserve the integrity of an important aspect of that program: the recognition of in-kind gifts of property. The next section of the note reviews the development of marketed tax shelters in the charitable sector. We argue that this development indicates an important weakening of the non-tax factors that otherwise have tended to serve as a constraint on “abusive” gifts to charities. In this respect, we define “abusive” gifts as those made through a marketed transaction in which the value of donated property or the amount of a cash gift is inflated in an effort to inflate the associated tax relief. The last section describes and evaluates the possible forms that a legislative response could take and compares these possible forms with the approach of the December 2003 draft legislation. In contrast with the response of the Department of Finance, our preferred response would deny the recognition of any amount in respect of an in-kind gift of property or a leveraged cash gift where the gift is made as part of a marketed donation scheme.

ABUSING THE RECOGNITION OF CHARITABLE GIFTS: ART FLIPS AND THEIR PROGENY

In the past few years, particularly with the virtual elimination of Canadian film tax shelters, a proliferation of mass-marketed tax shelters has emerged involving charitable donations of in-kind gifts, particularly artwork. In the midst of the CCRA’s

18 See, for example, Jonathan Chevreau, “Charitable Tax Schemes Unplugged,” National Post, December 9, 2003. But see Marilou McPhedran and Gardner Church, “Hands Off the Helping Hand,” Globe and Mail, December 17, 2003, suggesting that the Department of Finance should carve out those buy-low, donate-high schemes promoting in-kind gifts destined for third world countries. McPhedran and Church give the example of a tax shelter for purchasing rice in China at a cost of $3,000 and getting a charitable receipt for $18,000 based on the rice’s retail value in Canada (thus saving participants $4,800 in taxes); they suggest that in the absence of the tax shelter, taxpayers would have to spend $18,000 to buy the same rice, netting a tax refund of $8,400 and therefore costing the government almost twice as much. Their logic is fundamentally flawed. If a taxpayer can acquire rice from China for $3,000 through the tax shelter, the Canadian government also could buy the rice in China for $3,000. In fact, its cost would probably be a lot less because the tax shelter promoter would be eliminated as the middleman, so that the tax shelter really costs the government at least $1,800 more than it needs to spend to accomplish the same result (assuming that it considers the purchase of rice in China an appropriate use of tax dollars).
challenge of many of these “art deals,” other in-kind donation schemes, perhaps intended to receive a more sympathetic hearing from a judge if ultimately challenged, were touted; some were even marketed over the Internet, complete with tax and legal opinions. All of the in-kind gift tax shelters have one thing in common: taxpayers would purchase property for a low price and, upon donating it to a charity, usually arranged in advance by the scheme’s promoter, would receive a charitable donation receipt substantially greater than the taxpayer’s cost and supposedly equal to the property’s fair market value. In fact, the charitable donation was marketed on its positive, after-tax cash flow, in that the tax credit based on the supposed fair market value of the donated property was greater than the total of the property’s cost to the taxpayer and the tax, if any, payable on the gain realized on the donation.

At the same time that buy-low, donate-high deals proliferated, another charitable donation scheme, referred to as “leveraged gifts,” evolved. A leveraged gift scheme involves cash gifts where the scheme’s promoter arranges for the taxpayer to borrow a substantial portion of the amount gifted. In terms of its legal form, the loan may be full recourse, although the scheme involves some form of side investment by the taxpayer—for example, in an investment fund or insurance policy—that is intended to cover the taxpayer’s liability under the loan (although not so as to run afoul of the limited-recourse loan rules in section 143.2, at least as they applied before the December 2003 draft legislation). Leveraged gifts present an issue similar to that in the buy-low, donate-high schemes: that is, the stated amount of the charitable gift is higher than the economic cost of the gift to the donor.

**Buy-Low, Donate-High Schemes**

Charitable donation schemes involving artwork and other collectibles appear to have originated in Quebec in the early 1980s. Many of these early schemes bordered on fraudulent activities carried out by the schemes’ promoters. Some schemes were designed as much to bilk “investors” as to cheat the CCRA. Some of these schemes involved art dealers in cahoots with charities or public art galleries: the art dealer would sell works of art to individual clients and arrange to have the works donated to institutions that issued tax receipts for amounts significantly greater than the cost of the art to the individual. The receipted amount was generally based on a valuation of the artwork provided by the art dealer who promoted the scheme. In many cases, there was no independent valuation. The recipient institution in turn would hire the art dealer to dispose of the art by auction, often to other clients of the art dealer, who in turn would donate the art, perhaps even to the same institution. In all of these early cases, the CCRA successfully reassessed the taxpayer either by denying the donation completely, on the basis that the scheme was fraudulent.

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19 See, for example, *Ball v. The Queen*, [1993] 2 CTC 2475 (TCC); and *Ball v. The Queen*, [1993] 2 CTC 2474 (TCC). In *Gardner v. The Queen*, [1993] 2 CTC 2480 (TCC), the taxpayer abandoned the appeal of the denied charitable contribution but successfully challenged the subsection 163(2) penalties.
or technically deficient (for example, because the taxpayer never acquired ownership of the art or the donation receipt did not comply with the regulations), or, where the donation was a valid gift, by limiting the donation to an amount close to the taxpayer's cost. In many of these cases, the CCRA also successfully imposed penalties under subsection 163(2).

One point is clear from these early cases (assuming that a valid donation was made that was not technically deficient). While judges readily rejected the fair market value of the artwork suggested by the commercial galleries that promoted the schemes, they did not simply accept the cost of the artwork to the individual donor as its fair market value. The following summary from the Federal Court of Appeal decision in Côté (in which the art dealer involved had previously been

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20 See, for example, Chabot v. The Queen, 2002 DTC 6708 (FCA). Interestingly, the majority of the Federal Court of Appeal allowed the taxpayer's appeal concerning penalties. Referring to the CCRA's guidebook on charitable giving, Décary JA stated, at paragraph 39, “This guide more or less invites ‘individual taxpayers’ (‘Are you an individual planning to give money to your favourite charity? Do you own an oil painting . . . that you would like to give to a gallery or museum? Are you having your gift appraised?’ (page 63)) to make a gift so that ‘if you give money or property to certain institutions, you may be able to claim tax credits.’ The guide also allows for ‘a qualified staff member of the institution’ to appraise the gift, to avoid an ‘unreasonable expense’ (page 72).” He concluded, at paragraph 41, “I find it difficult to understand why Revenue Canada would assess penalties against such small taxpayers who, in good faith, tried to benefit from a tax credit that Revenue Canada itself dangled in front of their eyes and which, according to the guide, seemed so easy to obtain.” With respect, the CCRA has issued warnings concerning charitable donation schemes for a number of years. Fact sheets on art donation arrangements (similar to that mentioned in note 26, infra) were issued in December 1999 and November 2002. Even predating these, as early as 1993, the CCRA issued warnings to charitable organizations concerning art donation schemes: see “Issuing Receipts for Gifts of Art” (Spring 1994) no. 4 Registered Charities Newsletter, referring to a press release issued in April 1993 concerning “a tax-receipting scheme” in which “some charities received gifts of art for which they issued receipts to the donor for an amount well above the fair market value of the art.”

21 See, for example, Bérubé v. The Queen, [2002] 4 CTC 2147 (TCC).

22 See, for example, Arvisais v. MNR, 93 DTC 506; [1993] 1 CTC 2473 (TCC); Paradis v. The Queen, [1997] 2 CTC 2557 (TCC); The Queen v. Côté et al., 2000 DTC 6615; [2001] 4 CTC 54 (FCA); aff’g. 99 DTC 72; [1999] 3 CTC 2373 (TCC); and The Queen v. Duguay et al., 2000 DTC 6620; [2002] 1 CTC 8 (FCA); aff’g. 99 DTC 100; [1999] 3 CTC 2432 (TCC). The decisions in Côté and Duguay dealt with the same charitable donation scheme (described in this paragraph of the text).

23 The importance of form in in-kind donations is illustrated in The Queen v. Friedberg, 92 DTC 6031; [1992] 1 CTC 1 (FCA). The taxpayer financed the purchase by the Royal Ontario Museum (ROM) of two collections of ancient textiles, in both cases valued by the Canadian Cultural Property Export Review Board at amounts significantly higher than their cost. In the first case, the documentation reflected a direct sale by the third-party vendor to the ROM (which the ROM subsequently attempted to “correct” to show the taxpayer as the purchaser and donor), while in the second, legal title clearly passed to the taxpayer before being transferred to the ROM. The Federal Court of Appeal denied the taxpayer's cultural property deduction for the first collection, limiting him to a charitable donation equal to the cash outlay, on the basis that it was not the taxpayer who made the gift of the collection to the ROM; rather, the ROM purchased the collection from the third party with money provided by the taxpayer.
convicted of the destruction of records and tax evasion) illustrates the evidence that judges have taken into account in these cases:

In order to determine fair market value, the Judge used various methods: he relied at times on the testimony of expert witnesses, at other times on the fact that the property itself, at auction, could not even fetch a reserve price well below the appraised value submitted by the respondents, at other times on the prices actually paid at auction for works for which there was no market other than auctions, at other times on prices actually paid for works by the same artist that were comparable in size, subject matter and time period, and at other times on the sale or buy-back price of property that was immediately resold at auction by the donee. The judge took into account the relevant market where supply and demand operated and where the work could have been sold, or in fact, was resold shortly thereafter: his approach cannot be criticized.24

The point to be taken from these cases is that in order for the CCRA to successfully challenge such schemes (assuming that the donations are found to be valid gifts), it cannot simply argue that the fair market value of the artwork donated was equal to the amount paid by the donor for the artwork, even if such acquisition occurred in close temporal proximity to the donation. Rather, the CCRA must lead its own evidence as to fair market value. Thus, the potential cost involved in successfully reassessing taxpayers in massive art donation schemes—particularly those involving thousands of pieces of art—becomes enormous.

The 1990s saw a significant proliferation of art donation schemes that were intended to avoid the same fate as the earlier Quebec schemes. Typically, a promoter would enter into an agreement with the taxpayer pursuant to which the taxpayer purchased certain artwork from the promoter and the promoter agreed to assist the taxpayer in locating a registered charity or other institution that could issue charitable donation receipts. The promoter would obtain two “independent” valuations of each piece of artwork donated, generally undertaken by commercial art dealers. In many of these schemes—particularly those that took place before February 27, 2000—the cost of each individual piece of art was substantially lower than $1,000 while the valuation was in the neighbourhood of $1,000, generally three to four times more than the taxpayer’s cost. Although the taxpayer likely never saw the artwork purchased and donated, the taxpayer would file on the basis that the property was personal-use property, so that the de minimis rule in subsection 46(1) applied and the taxpayer would not realize any gain or loss on the donation. Thus, the after-tax benefit of these schemes was equivalent to a donation of cultural property to a designated institution under the Cultural Property Export and Import Act.

The CCRA has reassessed many of these donation schemes by limiting the taxpayer’s charitable donation to the cost of the artwork donated and also assessing

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24 Côté, supra note 22, at paragraph 14 (FCA). For similar comments, see Duguay, supra note 22, at paragraph 14 (FCA).
gross negligence penalties under subsection 163(2). There are two bases for the reassessment: first, that the property was not personal-use property and therefore the de minimis rule did not apply; and second, that the value of the artwork was grossly overstated in the charitable receipts. These cases involve thousands of taxpayers and millions of dollars of income taxes. Three of these schemes are currently before the Tax Court awaiting trial of test cases; a number of similar schemes are at the objection stage. The CCRA has offered to settle the art cases by dropping the subsection 163(2) penalties. Not surprisingly, few taxpayers have taken up the CCRA on this offer, and two recent court decisions—both involving one-off cultural property donations—suggest that the CCRA will face an uphill battle in challenging such schemes.

The Queen v. Zelinski et al. involved three lawyers who purchased over 200 works of art by Norval Morrisseau, a prominent native Canadian artist, with the specific intent of donating the works as cultural gifts to public art galleries. The aggregate cost of the works was approximately $130,000 and the aggregate fair market value, according to appraisals performed by the Professional Art Dealers Association of Canada Inc. (PADAC), upon which the donation receipts issued by the art galleries were based, was approximately $990,000. Assuming a 50 percent combined federal-provincial tax rate, the after-tax value of the donation ($495,000) resulted in an after-tax “profit” to the taxpayers of over $350,000 (since the artwork constituted cultural property and the capital gain on disposition was exempt from tax). The CCRA challenged the taxpayers on two grounds: that the purchase and donation of the artwork constituted an adventure or concern in the nature of trade, and that the valuation of the artwork was grossly inflated. At trial, Mogan TCCJ concluded that the artwork was capital property to the taxpayers, although he reduced the value of the donated works to $660,000, rejecting the expert evidence of both the taxpayers and the CCRA and substituting his own value.

25 The promoter of one of these schemes, Artistic Ideals Inc., has sued the CCRA for $51 million, alleging that CCRA officials threatened and intimidated the plaintiff’s clients in an attempt to drive the plaintiff out of business (Globe and Mail, October 23, 2003).

26 According to a fact sheet on “Tax Shelter Donation Arrangements” released by the CCRA on November 25, 2003, the CCRA has reassessed about 5,000 individuals involved in donation arrangements and is in the midst of conducting audits on another 5,000 individuals. For the full text of the fact sheet, see the CCRA’s Web site at http://www.ccra-adrc.gc.ca/newsroom/factsheets/2003/nov/1125taxshelter-e.html. We have since been informed by the CCRA that the 5,000 reassessed taxpayers were involved in art flips representing $90 million in federal income taxes (that is, exclusive of provincial taxes, interest, and penalties).


28 Interestingly, a significant volume of art by the same artist was valued using an amount per square inch, a methodology commonly employed in the commercial art industry. Mogan TCCJ concluded that the $3.00 per square inch formula used by PADAC was inflated, particularly given the personal circumstances of the artist at that time. According to Mogan TCCJ (supra...
In dismissing the Crown’s appeal (on characterization) and the taxpayer’s cross-appeal (on valuation), the Federal Court of Appeal agreed that artwork acquired for the specific purpose of donation cannot constitute an adventure or concern in the nature of trade because there is no intention to profit, as that term is understood for income tax purposes. The reduction of tax cannot, in and of itself, constitute a business purpose. Furthermore, the Federal Court of Appeal was not prepared to upset the Tax Court’s determination of value, concluding that the trial judge considered each expert’s appraisal method and arrived at his own opinion of valuation based on a careful consideration of all the evidence.

Recently, in *Malette v. The Queen*, the Tax Court confirmed that a bulk discount could not apply to donations of cultural property. In *Malette*, the taxpayer (with two others) donated 981 paintings by the same artist to the Art Gallery of Algoma. The taxpayer acquired the artwork directly from the artist (and his agent) in a readily acknowledged “tax-driven transaction” (although not a mass-marketed transaction like the art deals noted above). The purchase price agreed to for the 981 pieces was 25 percent of the certificate amount determined by the Cultural Property Export Review Board, with $50,000 paid at the time of sale and the balance paid at the time the certificate was issued. This case concerned an appeal by the taxpayer of the amount set out in the certificate. The parties to the proceeding agreed that the fair market value of the works, absent a bulk discount, was $828,000, and the only issue on appeal was whether it was appropriate to apply a discount, as was done by the review board. Beaubier TCCJ concluded that no bulk discount applied because the statutory provisions dealing with donations of cultural property under the Act and the Cultural Property Export and Import Act specifically refer to gifts of an “object” in the singular. Subsection 118.1(1) defines...
“total cultural gifts” in part as “the total of all amounts each of which is the fair market value of a gift (a) of an object.” According to Beaubier TCCJ,

[d]onations of art to public galleries often consist of a large number of works. Such donations are to be encouraged so that the works are presented and shown to the public. It is difficult to imagine that a donation of ten or many more paintings by a famous international artist such as Renoir would be discounted. Rather, they would be applauded generally. It is equally difficult to imagine that they would be subject to a block discount to determine their fair market value. On the contrary, the value of the gallery would be multiplied by the critics and the public.32

In the mass-marketed art donation cases, it is questionable whether the same reasoning would preclude a bulk discount applying to a charitable donation of artwork that is not cultural property. Specifically, the definition of “total charitable gifts” in subsection 118.1(1) refers to “the total of all amounts each of which is the fair market value of a gift.” Although “gift” is in the singular, it is arguable that, in the absence of the reference to “gift of an object,” a one-time gift to a charity comprising several items is a singular gift and that it may be appropriate, depending on the nature of the property donated, to apply a bulk discount.33

Even if a bulk discount would not apply to a donation of a number of pieces of artwork, presumably on the basis that each piece is unique and should be separately valued as a separate gift, it is difficult to conceive the basis upon which a bulk discount would not apply to the donation of commodities, such as rice, beans, or barley grass, pharmaceuticals, or multiple copies of the same computer program. Consider three buy-low, donate-high schemes that were marketed over the Internet during 2003: the “Canadian Hunger Relief Gifting Program,” “Canadian Gift Initiatives,” and “Global Learning Systems.”34 Under the first, taxpayers could purchase units of food, each comprising 425 to 450 kilograms of rice and/or kidney beans, packaged in either 2 kilogram or 5 kilogram bags, plus 30 to 40 kilograms of powdered barley grass, packaged in 1 kilogram bags, for $1,700 per unit. At the taxpayer’s request, the scheme’s promoter would find qualified charities (including Global Relief Fund, Canadian Feed the Children, and Canadian Association of Food Banks) to which to donate the food and, evidently, would secure for the taxpayer a charitable donation receipt in the amount of $10,000 per unit, supposedly reflecting the fair market value of the food when donated. The marketing literature

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32 Supra note 29, at paragraph 18.
33 That said, it is likely that the CCRA will attack the mass-marketed cases on the basis of valuation methodology, of which bulk discount is but one issue. In Malette, the Crown accepted the valuation absent the bulk discount. It is unlikely that the taxpayers’ valuations will be accepted in the recent mass-marketed donation cases, absent a bulk discount.
promoted the scheme’s altruism in combination with its tax advantages; if the scheme works, the tax advantages can be great. For an individual in Ontario subject to tax at the top marginal rate, the after-tax return for the donation is 60 percent (after taking into account both the cost of each food unit and the tax payable on the resultant capital gain). If the taxpayer has capital losses to offset the gain, the return increases to 173 percent. The Canadian Gift Initiatives 2003 donation program and the Global Learning Systems program were similarly structured and advertised similar rates of return.

The issue at the heart of these charitable giving schemes—even more blatant than the art donation schemes—is whether the fair market value of the goods donated can be substantially greater than their cost to the taxpayer shortly before their donation. In none of these schemes can any claim be made that each property donated is in any way unique. In all three cases, the donation is of fungible bulk property. In the feed the children scheme, for example, the taxpayer is not repackaging the food into individual meal portions; the taxpayer is not even buying the food in

35 One online brochure for the program showed a starving African child, an image typically associated with Oxfam or Canadian Feed the Children campaigns, together with the following comments:

Canadians Change the World gives you a chance to matter. A reach long enough to touch those in need.

From the starving, to the sick, to the underprivileged. They will feel your support.

And, by taking part in a Canadians Change the World program, you will be entitled to considerable tax advantages.

Similarly, the online advertising literature for the Canadian Gift Initiatives 2003 included the catchy phrase “By Saving Taxes, You Save Lives.”

36 The Canadian Gift Initiatives 2003 donation program involved the donation of pharmaceuticals and other humanitarian products (including seeds, medical devices, and medical diagnostic devices). The advertising literature provided the example of goods purchased for $10,000 (although a discount ranging from 3 percent to 14 percent applied, depending on how early in 2003 the goods were purchased) that were evidently worth $56,500. For individuals resident in Ontario, the advertised after-tax return was 54 percent, increasing to 162 percent if the taxpayer could shelter the resultant capital gain. See James Daw, “Tax Shelter Helps Poor Get Medicine,” Toronto Star, December 4, 2003, for an interesting discussion of the business arrangements underlying the pharmaceutical deals.

Under the Global Learning Systems scheme, taxpayers could purchase multiple copies of educational software in various packages ranging in cost from $500 to $10,000, with the fair market value of the package in each case being six times the amount paid (for example, $3,000 for each $500 package; $60,000 for each $10,000 package). For individuals resident in Ontario, the advertised after-tax return was 62.4 percent, increasing to 178.5 percent if the taxpayer could shelter the capital gain. The promotional literature available on the Global Learning Systems Web site warned readers that the CCRA had disputed various charitable donation schemes and acknowledged that a similar challenge could be made to this scheme. According to the literature, “GLS warrants that it will coordinate, organize and assist in defending any reassessment of such GLS transactions as a result of an audit by CCRA. GLS warrants that it will engage and pay the professional costs of defending any reassessment of such GLS transactions as a result of an audit by CCRA.” Evidently, part of the funds raised by promoters in these various schemes was set aside to cover anticipated litigation costs.
bulk and breaking it down into smaller packages for redistribution to the charity. It is already prepackaged in exactly the manner in which it will be delivered to the charity. Similar concerns arise with respect to the Canadian Gift Initiatives and Global Learning Systems schemes. How can the promoters of these programs offer goods for sale at such substantial discounts compared to their fair market value in an open and competitive marketplace?

**Leveraged Donation Schemes**

Leveraged donation schemes did not receive the same amount of negative press as buy-low, donate-high schemes, perhaps because most leveraged donation schemes were not brazenly marketed over the Internet. However, they raise substantially similar concerns in terms of undermining the intent of the tax expenditure program for charitable giving.

Under a leveraged donation scheme, the promoter would arrange for donors to borrow a substantial portion (generally over 80 percent) of the amount pledged to a registered charity. The loan would have a 10-year term, with interest payable at current market rates. The donor would then purchase an insurance policy or invest in some form of structure, again arranged by the scheme’s promoter, that was designed to ensure repayment of the borrowed amount. For example, the insurance-backed schemes typically gave the donor a put option exercisable after March of the following year (that is, within four months of a December donation) whereby the insurance policy could be assigned to the lender in full satisfaction of the amount borrowed.

Often, leveraged donation schemes also involve the charities’ either investing a significant portion of the money donated through an entity related to the scheme’s promoter (perhaps at the financial institution that loaned money to participants) or purchasing goods or services from the entity that lent money to participants. Thus, there is often circularity to the flow of funds in these schemes. The schemes are marketed on the same basis as buy-low, donate-high schemes: that is, the taxpayer’s out-of-pocket cost of the donation is significantly lower than the tax savings that the scheme generates.

**THE DECEMBER 2003 DRAFT LEGISLATION: A COMPREHENSIVE LEGISLATIVE RESPONSE TO CHARITABLE DONATION SCHEMES?**

Art flips and their progeny make a cruel mockery of the government’s matching grant program for charitable gifts. Under this program, the government agrees to match at the specified two-tier rate (or the relevant corporate rate in the case of the taxable income deduction for corporate gifts) the contribution of a taxpayer. But the amount of the matching grant is predicated on the assumption that a contribution is, in fact, made by the taxpayer in the sense that the taxpayer has given up value equal to the stated amount of the gift. The presence of unsupported value means that the matching grant element is eroded to the point of elimination, where
the gift generates tax relief in an amount in excess of the cost of donated property or, in the case of leveraged gifts, in excess of the amount of the cash gift for which a donor is at risk of loss. To the extent of this erosion, the government provides the whole of the funds to a charity without any contribution by the taxpayer. The government’s cost is more than a direct subsidy payment without any taxpayer contribution, and yet the government has no control over the direction of the payment. Allocation of resources to the charitable sector is distorted by the direction of government resources to those charities that are willing and able to engage in subversion of the matching grant program under the Act.

The valuation problem associated with the recognition of in-kind charitable gifts has long been recognized. It is arguable that consistency of tax treatment of cash gifts and in-kind gifts of property is desirable and worth the problems of valuation, provided that those problems are manageable. In this respect, there appear to be various factors that, until recently, have been sufficient to constrain the tax-driven overstatement of value. On the supply side, it may be that charities have been reluctant in the past to get involved in schemes that are blatantly intended to abuse the matching grant program for charitable gifts under the Act. This attitude may have been reinforced by problems in satisfying disbursement quotas where an inordinate amount of in-kind gifts is accepted. On the demand side, the availability of alternative tax shelter investments may have steered investors away from charitable gift schemes, which may have been perceived as much more dubious given their non-commercial nature. Given the recent growth in charitable gift schemes, the effect of these non-tax constraints has obviously weakened. Competition for scarce funds may be driving charities into such schemes, with investors driving up demand in the face of legislative restrictions on tax shelter investments generally. How charities manage compliance with their disbursement quotas in the face of a stream of in-kind gifts is not clear to us.

The growing volume of gifting transactions designed to take advantage of overstated valuations made reliance on direct challenges of property value impractical

37 See, for example, Canada, Report of the Royal Commission on Taxation (the Carter report), vol. 3 (Ottawa: Queen’s Printer, 1966), 225 (accepting the case for recognition of in-kind gifts of property, subject to the problem of valuation).

38 Generally speaking, a charity must expend on charitable activities in a taxation year at least 80 percent of the total gifts received in the immediately preceding taxation year (subsections 149.1(2), (3), and (4) and the definition of “disbursement quota” in subsection 149.1(1)). Where a registered charity receives an in-kind gift that cannot itself be expended in fulfilling the charity’s charitable activities (as in the case of artwork), the charity must expend in the following year at least 80 percent of the total value stipulated in its charitable receipts. Where a charity has accepted an inordinate amount of artwork the value of which is substantially inflated, the charity may jeopardize its ability to reach its disbursement quota because it lacks sufficient cash donations and cannot realize sufficient proceeds from the sale of overvalued artwork. This concern was highlighted in a recent newspaper article: Paul Waldie, “Tax Shelters Being Abused, Charities Say,” Globe and Mail, December 1, 2003. The article quoted the following comment by Malcolm Burrows, director of development and gift planning at the Hospital for Sick Children Foundation (Toronto) and chair of government relations for the Canadian
and apparently forced the Department of Finance to introduce the December 2003 draft legislation as an alternative approach. The administrative and judicial resources devoted to the valuation effort had the potential to be enormous—in our view, a waste of government resources that could be put to use much more effectively in other areas. We concede that the precise point at which this conclusion can confidently be drawn is not obvious. But we believe that the growth of this particular form of abusive tax shelter has crossed the line below which direct challenges to valuation are administratively manageable and effective. This conclusion is much easier to draw when it is possible to design a comprehensive legislative response that uses a relatively accurate proxy for valuation.

There are two general legislative responses that can be used as an alternative to a direct challenge of the valuation of property that is the subject of an in-kind charitable gift. One alternative is simply to deny the recognition of any such gifts for tax relief purposes. This approach, which is used in New Zealand, is based on the premise that the tax-avoidance opportunities with in-kind charitable gifts are such that the vast majority of these gifts are abusive in the sense that the value of the relevant property is overstated. Problems with the overstatement of value are eliminated at the expense of the recognition of in-kind gifts that are not abusive. In effect, no attempt is made to distinguish abusive gifts from legitimate gifts. Compliance and administrative costs associated with maintenance of this distinction, as well as the potential to convert revenue account gains into capital amounts, warrant

Association of Gift Planners: “Small and naïve charities get victimized by the promoters of these arrangements. Charities are offered what seem to be very large gifts, and they are hard to refuse. But charities put themselves at risk of not meeting their disbursement quotas and losing their charitable status.” The more recent in-kind donation schemes involving bulk food or pharmaceuticals may have been designed to avoid the disbursement quota problem because the recipient charity could disburse the donated goods rather than sell them in order to finance charitable activities. In this way, the charity could take the position that the amount expended (that is, the value of the goods disbursed) is equal to the value of the in-kind gifts received.

Leveraged donation schemes may rely on one of the exceptions to the disbursement quota, specifically that excluding endowed funds (see paragraph A(b) of the definition of “disbursement quota” in subsection 149.1(1)). Provided that the gift received by a charity is subject to a minimum 10-year holding period (perhaps not surprising, the same term as the typical loan arranged for the donor in leveraged donation schemes), 80 percent of the amount of the gift need not be disbursed in the following year.

39 See New Zealand, Tax and Charities: A Government Discussion Document on Taxation Issues Relating to Charities and Non-Profit Bodies (Wellington, NZ: Inland Revenue, Policy Advice Division, 2001), 50: “The government also considered whether donations other than in cash should also be eligible for the rebate. However, to allow this would lead to increased compliance costs for taxpayers, and administrative costs for Inland Revenue, as it would give rise to questions as to the valuation of the donated goods and services. When rebates are available for non-cash donations, complex valuation rules are required, and anecdotal evidence from other jurisdictions suggests this can give rise to tax planning opportunities. Even when values are readily identifiable, the outcome of donating goods or services needs to be the same as when the goods or services are sold and the proceeds donated. For example, tax on the sale of a revenue account asset should not be avoided by donating the asset. Because of these complexities, the rebate would not be extended to non-cash donations.”
rejection of the recognition of all in-kind gifts. The overinclusiveness of a blanket non-recognition rule is thus tolerated in the face of these kinds of policy considerations. To ensure recognition of such gifts, taxpayers and charities are forced to incur the transaction costs associated with the sale of property, followed by a gift of the cash proceeds and an acquisition of the property by the relevant charity.

Although we believe that a non-recognition rule for in-kind charitable gifts has considerable appeal, we harbour no illusions that such a rule is a realistic possibility in the Canadian context, given the longstanding extension of tax relief to this category of gifts. In this decidedly second-best context, a more target-efficient legislative approach must be used to attack overstatements of property. The alternative approach to either a blanket non-recognition rule or a direct challenge of property valuation has two basic elements, both of which are reflected in the December 2003 draft legislation. One element is the distinction between abusive and acceptable gifts. The second element is the elimination of overstated value for abusive gifts. Perhaps somewhat surprisingly, the task of developing this type of targeted legislative response is not as difficult as might at first appear. In fact, the recent legislative initiatives of the Department of Finance before the release of the December 2003 draft legislation were pointed broadly in the right direction. However, these initiatives failed to address comprehensively the policy problem presented by abusive in-kind charitable gifts, let alone the related problem of leveraged gifts. At a general level, this policy problem is no different from that presented by tax shelters generally; it requires a targeted response to in-kind and leveraged charitable gifts similar to the at-risk and limited-recourse debt rules that are used to address the same problem in the context of tax shelters generally.

Taking the targeting issue first, we emphasize again the policy problem that effectively defines “abusive” charitable gifts. For in-kind gifts, the problem is the incentive to inflate the value of donated property as a means of magnifying the associated tax relief. For leveraged gifts, the problem concerns monetary gifts where the economic cost to the donor is substantially less than the amount given, so that the value of the donation is similarly inflated.

A legislative response that eliminates the recognition of overstated value serves as a necessary brake on the incentive to inflate value. In defining the range of abusive in-kind gifts legislatively, there are three types of approaches, all of which are focused on the potential overstatement of value that is the source of the abuse.

One definitional approach, which is qualitative in nature, focuses on the presence of specified features that are the basis of donation schemes intended to serve as tax shelters. An example of this type of application rule is found in the legislation that denies the availability of the $1,000 de minimis threshold for charitable gifts of personal-use property. As a targeting mechanism, subsection 46(5) identifies abusive in-kind gifts as those in which

property is acquired by a taxpayer (or non-arm’s length person) in circumstances in which it is reasonable to conclude that the acquisition relates to an arrangement, plan or scheme that is promoted by another person or partnership under which it is reasonable to conclude that the property will be the subject of a charitable gift.
In short, donation schemes are identified in terms of their marketed feature. A similar approach is used in the definition of a “gifting arrangement,” which was added when the tax shelter reporting rules were extended to charitable gift schemes in the 2003 budget.\footnote{Supra note 14.} In the case of in-kind gifts, such arrangements are those in which it may reasonably be considered, having regard to statements and representations made in connection with the arrangement, that a person entering into the arrangement would make a charitable gift of property acquired under the arrangement. In the case of leveraged gifts, the targeted arrangements are those in which the donor will incur a limited-recourse debt that reasonably relates to a charitable gift.\footnote{The December 2003 draft legislation amends paragraph (b) of the definition of “gifting arrangement” in section 237.1 to replace the reference to “limited-recourse amount” with a reference to “limited-recourse debt, determined under subsection 143.2(6.1).” Even so, it is our view that the provision is underinclusive, as discussed below.}

A second definitional approach, which is quantitative in nature, focuses on a comparison of the amount of the tax cost of donated property to a taxpayer and the amount of available tax credits or deductions. An example of this type of targeting measure is the tax shelter reporting rules now applicable to “gifting arrangements” that involve in-kind gifts. The reporting rules apply where the amount of tax credits or deductions represented to be available, within the four years after the scheme is entered into, exceeds the cost of the property to a donor (excluding prescribed benefits). In effect, the legislation identifies in-kind donation schemes as tax shelters where the amount of the expected tax relief within the specified time frame exceeds the donor’s economic cost, determined as the amount that the donor has invested in the property and in respect of which the donor is at risk of loss.

A third definitional approach combines both a qualitative and a quantitative approach. For example, abusive donations could be defined in terms of the time frame during which the donated property was held by the donor. Where a minimum holding period is not satisfied, the donation would be identified as a tax shelter. In effect, the identifying qualitative feature of abusive transactions would be the nature of the property acquisition and donation as a “flip” of the property. A quantitative aspect to the definition of abusive transactions would be introduced through the use of a bright-line holding period as the boundary between flips that are considered to be indicative of abusive transactions and those that are not. The extension of the tax shelter reporting rules to in-kind donation schemes has hybrid characteristics: the schemes must have a marketing feature (the qualitative element) and generate tax credits or deductions exceeding the taxpayer’s cost within four years (the quantitative element).

Assessing these alternatives in terms of the necessary quality of inclusiveness, we think that there is a marginal preference for a qualitative approach, provided that the concept of a marketed transaction is described legislatively in the kind of broad sense used in subsection 46(5) (modified as necessary to account for leveraged donation
schemes).\textsuperscript{42} In particular, the concept of an arrangement should be a broad one that covers the range of marketed transactions associated with an overstatement of the value of donated property. Although the problem of overvaluation remains with non-marketed transactions, we believe that these transactions can be dealt with satisfactorily by challenging valuations directly.\textsuperscript{43} It is the marketing feature of donation schemes that, in fact, has caused abusive transactions to multiply to the extent that the administrative and judicial resources associated with direct valuation challenges have become severely strained, requiring an alternative response.

The principal drawback of any quantitative element in the definition of targeted transactions is the discontinuities associated with the bright-line nature of the standard. The discontinuities arise as small changes in the relative amount of tax relief and the economic cost of donated property or the holding period of property produce disproportionately large differences in the application or non-application of limitations on the amount of tax relief. In the context of in-kind charitable gifts, there does not appear to be much in the way of non-tax factors that would constrain tax planning focused on bright-line definitions of the boundary between abusive and acceptable gifts. We also note that there is no necessary reason why the definition of abusive gifts for the purpose of restrictions on tax relief should be consistent with the definition used for tax shelter registration purposes. It may be that a quantitative aspect is defensible in the latter context but not in the former. That said, we see no obvious reason why that might be the case and would prefer the kind

\textsuperscript{42} The definition of “gifting arrangement” in subsection 237.1(1) could also be used, although in our view it should be amended to include any gifting scheme in which the taxpayer would be subject to an at-risk adjustment, as defined in subsection 143.2(2), rather than limiting such schemes to those involving limited-recourse debt. Our preference is to use a modified version of subsection 46(5), as discussed below.

\textsuperscript{43} Evidence from the United States suggests, however, that valuation problems are endemic when in-kind gifts are permitted. For example, the US Government Accounting Office (GAO) recently issued a report highlighting valuation problems with in-kind gifts of automobiles: United States, General Accounting Office, \textit{Vehicle Donations: Benefits to Charities and Donors, but Limited Program Oversight}, GAO-04-73 (Washington, DC: General Accounting Office, November 2003). Of the 54 specific vehicle donations that the GAO examined for its report, two-thirds generated proceeds to the charity of 5 percent or less of the value that donors claimed in their tax returns. However, in contrast to Canada, where the charity prepares the tax receipt and specifies the valuation for charitable donation purposes, US taxpayers often value in-kind gifts themselves and an independent valuation is not required where the value of each property item (or group of similar items) is less than $5,000 (IRS form 8283, “Noncash Charitable Contributions” and IRS Publication 526, “Charitable Contributions”). According to the GAO report, the Internal Revenue Service has some procedures designed to detect overvaluations of in-kind donations but has not pursued potential leads because the expected tax revenue yields are not worth the effort involved. Thus, US taxpayers have a propensity for overvaluation of in-kind gifts under $5,000. See also Stephanie Strom, “Closer Look at Deductions for Donations to Charity,” \textit{New York Times}, December 12, 2003; and, more generally regarding valuation issues with in-kind gifts in the United States, Burgess W. Raby and William L. Raby, “When Charity Begins at Home” (2004) vol. 102, no. 1 \textit{Tax Notes} 95-98.
of qualitative targeting approach suggested here for the purposes of both any limitation on tax relief and tax shelter reporting.

The December 2003 draft legislation is broadly consistent with our preferred targeting approach. With respect to in-kind charitable gifts, the targeted transactions are defined primarily in terms of marketed transactions, which are described qualitatively in the concept of a “gifting arrangement” in subsection 237.1(1).\textsuperscript{44} We do, however, have considerable difficulty with the extension of the range of targeted transactions to inter vivos gifts of property, where either the property is held by the donor for a period of less than three years or the property was acquired with the expectation that it would be the subject of a charitable gift.\textsuperscript{45} These extensions appear to be intended to address non-marketed donation transactions in which taxpayers attempt to replicate the tax results otherwise associated with a marketed buy-low, donate-high scheme. It is not clear to us that the potential for such transactions is of such a magnitude that they could not be addressed effectively through direct challenges to valuation. Even if the potential scope of these transactions is significant enough to warrant the use of the kind of alternative approach to valuation described here and reflected in the December 2003 draft legislation, we would prefer the avoidance of bright-line tests for the reasons suggested above. It would be preferable to simply extend the range of targeted transactions to non-marketed transactions defined qualitatively in terms of an expectation that acquired property would be the subject of a charitable gift. The December 2003 draft legislation realizes much the same effect by using the three-year holding period test as an irrefutable presumption rather than a safe harbour; that is, property that is gifted within the holding period is considered to be the subject of a donation scheme, although a gift made outside the holding period is not necessarily saved. However, the irrefutable presumption created by the three-year holding period test does strike us as somewhat overinclusive in that it may force some taxpayers to continue to hold property that they would prefer to donate, even though it was not acquired as part of a “homemade” buy-low, donate-high scheme.

We also have some difficulty with the specific exclusion of gifts of cultural property and ecologically sensitive land.\textsuperscript{46} Despite the use of the Cultural Property Export Review Board as an arbiter of value in the case of the former, cultural property has continued to give rise to the kinds of valuation problems that justify the adoption of the approach in the December 2003 draft legislation if the property is the subject of a marketed donation scheme. Much the same valuation difficulties may extend to ecologically sensitive land. In contrast, the explicit exceptions for publicly traded securities, inventory, and Canadian real property are defensible in terms of the policy problem that is the focus of the December 2003 draft legislation. In effect, the deep and liquid markets for these assets mean that direct valuation challenges can be effective when

\textsuperscript{44} Proposed paragraph 248(35)(a).
\textsuperscript{45} Proposed paragraph 248(35)(b).
\textsuperscript{46} Proposed paragraphs 248(36)(c) and (d).
such assets are the subject of donation schemes. Indeed, because of the nature of
the markets for these assets, they are unlikely to be the subject of such schemes.

For leveraged gifts, the December 2003 draft legislation defines the targeted
transactions in terms of a broad set of arrangements related to a cash gift where the
arrangements effectively provide some form of investor protection to a donor. How-
ever, there are weaknesses in the draft legislation that may be exploited by promoters
of such schemes. In this respect, we observe that the proposed rules are not a
model of clarity. They are incorporated in two new provisions, subsections 248(31)
and 143.2(6.1). Subsection 248(31) was first proposed on December 20, 2002 as
part of a series of provisions intended to deal with split receipting. Proposed
subsection 248(30) defines the eligible amount of a gift as the amount by which the
fair market value of the gift exceeds the amount of any advantage in respect of the gift.
In its original incarnation, subsection 248(31) defined the amount of an advantage
as the value of “any property, service, compensation or other benefit” received or
to be received “as partial consideration for, or in gratitude for, the gift or contribu-
tion.” The December 2003 draft legislation extends subsection 248(31) to include
as an advantage such property, service, or benefit “that is in any other way related
to the gift or monetary contribution.” Furthermore, it includes as an advantage a
limited-recourse debt, as defined in subsection 143.2(6.1). New subsection 143.2(6.1)
defines a limited-recourse debt as the total of various limited-recourse amounts
received by the taxpayer that can reasonably be considered to relate to a gift or
monetary contribution, as well as “each amount that is the unpaid amount... of
any other indebtedness... that can reasonably be considered to relate to the gift
or monetary contribution if there is a guarantee, security or similar indemnity or
covenant in respect that [sic] or any other indebtedness [emphasis added].”

While these proposals should catch insurance-backed leveraged donation
schemes where the donor has the option to put the insurance to the lender in full
satisfaction of the loan, we suspect that other leveraged donation schemes will
continue to be marketed or restructured on the basis that they are outside the scope
of the draft legislation. In particular, it seems that leveraged donation schemes can
be structured to avoid the definition of limited-recourse debt, but still effectively
limit a donor’s risk of loss where the relevant property, services, or benefit that
constitutes an offsetting advantage can arguably be considered to be unrelated to
the particular contribution. Problems with such schemes may be exacerbated for the
CCRA because the tax shelter reporting requirements, even as amended, apply to a
narrower class of leveraged donation schemes than those covered by subsection 248(31).
Moreover, while the proposed provisions are arguably underinclusive in some respects,
they might technically catch some legitimate donations. For example, if a taxpayer
simply borrows money to donate to a charity (that is, not as part of a marketed

47 Canada, Department of Finance, Legislative Proposals and Explanatory Notes Relating to Income
Tax (Ottawa: Department of Finance, December 2002), clause 118(15).
48 Proposed subparagraph 248(31)(a)(iii).
49 Proposed paragraph 248(31)(b).
donation scheme) and provides security for the loan—for example, a home mortgage—the mortgage appears to fall within the scope of proposed subsection 143.2(6.1), literally construed, and therefore under subsection 248(30) and paragraph 248(31)(b); as a result, the amount of the gift is reduced by the amount of the mortgage. In this respect, the proposed targeting provisions for leveraged gifts are overinclusive.

Our preferred targeting rule for leveraged gifts would focus exclusively on the existence of two features: first, a borrowing to make a monetary contribution; and second, the marketing of such a transaction to potential donors. Where these features coexist, we believe that the relevant gift or contribution is unlikely to be anything other than tax-motivated in the sense that the amount of the gift or contribution is overstated because of related loss protection or reimbursement arrangements. Our suggested targeting rule could be implemented simply by extending the kind of language used in subsection 46(5) to include leveraged gifts made in the context of a marketed gifting scheme.

Drawing on our comparison of donation schemes and tax shelters generally, the obvious response to the range of transactions considered to be abusive is to deny the recognition of that portion of the value of donated property, or the amount of a leveraged gift, that can confidently be assumed to be overstated. In this respect, considerations of administrative efficiency require the identification of proxies that can provide an accurate measure of value. In effect, the use of proxies eliminates overstatement of value but without the administrative costs associated with direct challenges to the valuation of donated property. In the context of tax shelters generally, the concept of an investor’s amount at risk is used as a proxy for the amount of the value of a tax-preferred asset that can give rise to associated tax benefits. The assumption is that, to the extent that an investor risks the loss of his or her own money, tax policy makers can have some confidence that the tax-preferred asset has at least that value, which can generate associated tax benefits. Any stated value in excess of the investor’s amount at risk is assumed to be overstated in an effort to inflate the associated tax benefits. At least as an initial proposition, much the same assumption can be invoked in the context of donated property and leveraged gifts. To the extent that a donor has incurred a cost of donated property that effectively represents economic cost in the sense of a transfer of value to the donee, it can be assumed that the donated property has at least that value as a gift, giving rise to tax relief. In other words, in-kind gifts would be recognized only to the extent of a donor’s cost of the donated property, which is the donor’s at-risk amount in respect of the property. Similarly, to the extent that a donor has borrowed to make a monetary contribution without any offsetting benefit that provides a form of reimbursement, the amount of that contribution can be respected. Leveraged gifts would be recognized only to the extent of the donor’s monetary contribution that is unsupported by any form of benefit equivalent to a form of investor protection.

The December 2003 draft legislation is generally consistent with this approach to the recognition of the amount of a targeted in-kind gift or leveraged gift. For targeted in-kind gifts, the legislation is relatively simple and straightforward: the fair market value of the gift is deemed to be the lesser of its fair market value otherwise determined and the taxpayer’s cost. For leveraged gifts, the amount of the gift is reduced by the amount of any advantage described in subsection 248(31). While subsection 248(31) is drafted broadly, it does have its limitations. For example, to be consistent with the treatment of other tax shelters, we suggest that the legislation should more closely parallel the concept of the cost of a tax shelter investment under section 143.2 and therefore reduce the amount of any monetary gift by both any limited-recourse debt and any at-risk adjustment, as described in subsection 143.2(2).

That said, our preference is that no amount of an in-kind gift or a leveraged gift be recognized where the gift is the subject of an “abusive” transaction defined along the lines suggested above. Non-recognition treatment of even the economic cost of donated property, or the amount of a leveraged gift for which a donor is not effectively reimbursed, would avoid the complexities associated with the determination of the cost subject to tax recognition (that is, the at-risk amount or the amount of the advantage). In effect, non-recognition would avoid the incentive to design gifting transactions that skirt the definition of a donor’s economic cost and attempt to provide recognition for value that is not necessarily given up by a donor.

A rule of non-recognition for targeted gifts is justified, we suggest, because charitable donation schemes are unlike tax shelters generally. In the latter case, investment in a tax-preferred asset—for example, the incentives for investment in Canadian resources or the former incentives for investment in Canadian films—can be effected only through a tax shelter structure because the preference targets a broad class of investors. Accordingly, recognition of an investment in such an asset should be extended to tax shelter structures, provided that the amount of the recognition is limited to an amount that tax policy makers can have some confidence is reflected in the value of the underlying asset. Non-recognition of an investor’s economic cost of the tax shelter investment would mean that investment in the tax-preferred assets would cease, and that is contrary to the policy goal of encouraging investment in such assets. Legislative and administrative efforts surrounding the definition of the scope of an investor’s at-risk amount are thereby justified as a means of balancing the policy goal of encouraging investment in tax-preferred assets against the need to constrain tax-driven overstations of asset value. In contrast, there is absolutely no reason why charitable gifts must be made as part of a marketed scheme. Charitable gifts can always be made directly by donors, with the full amount of the value of the property recognized for income tax purposes. Given this alternative method of donating property—in fact, the only method considered when tax incentives for charitable donations were originally introduced—it is arguable that interprettive pressure points that would otherwise surround the concept of a donor’s cost of donated property, or the amount of a leveraged gift, can defensibly be avoided by a simple rule of non-recognition of any amount in respect of property that is donated as part of a targeted donation scheme.