

December 2003

Important Update:

The Department of Finance has announced proposed changes to the *Income Tax Act* to limit the tax benefits from “buy-low, donate-high” charitable donations made under tax shelter and other arrangements.

As of 6:00 p.m. (EST) December 5, 2003, the value of a tax receipt issued by a charity for gifts of property, will be limited to the donor’s cost of the property where it is donated within three years of acquisition or acquired through a gifting arrangement.

For details on the proposed amendments to the Act, please refer to the Department of Finance news release: <http://www.fin.gc.ca/news03/03-061e.html>.

November 2003

Canada Customs and Revenue Agency

Tax Shelter Donation Arrangements

As tax filing season approaches, you may see a growing number of advertisements for tax shelter donation arrangements. While donating various items to a charity (such as art, computers, and prescription drugs) is a legitimate way of making a charitable donation, you should be aware of the risks associated with certain donation arrangements.

These arrangements involve items sold, often in bulk, through a promoter who donates them to a registered charity which then issues a tax receipt for a considerably higher amount than was paid for the donated items. This type of donation scheme results in an income tax credit for the donor greater than the price paid, and **may be disallowed by the Canada Customs and Revenue Agency (CCRA)** at a later date.

An example of this – A tax shelter promoter presents an arrangement to you where you can buy – without taking possession of – a quantity of supplies at a bargain basement price. The promoter then arranges for this to be appraised and donated to a registered charity, which will then provide you with a tax receipt based on the appraised value. The tax receipt will be high enough to produce a tax credit greater than the cost of the property plus any capital gains taxes resulting from the arrangement.

As a taxpayer, **you are responsible for the information on your tax returns**. If you are considering making an *in-kind* donation (something other than money) to a charity, you might want to take the following precautions:

- be wary of advertisements for property like art, books, or software that are valued at many times their cost and promise substantial tax savings through charitable tax receipts—especially if you do not get to see the property, or the charity has been pre-selected for you;
- consider requesting confirmation directly from the recipient charity, independent of the promoter, that it has agreed to receive the property and that it will exercise due diligence regarding the valuation of the property;
- pay close attention to statements or professional opinions in advertisements or other documents that explain the **income tax consequences** of the donation arrangement, especially any assumed facts (these opinions often describe potential problems and suggest that the taxpayer get independent legal advice);
- ensure that the **appraiser is a qualified and independent party** who is not connected to the promoters or sellers of the donation arrangement (generally, membership in a professional association is a good indication of an appraiser’s qualifications);
- review the **valuation or appraisal report** before making the donation as the report should indicate the professional appraiser is knowledgeable about the property and the market activity at the time of the donation. **Note that the CCRA is responsible for ensuring compliance with the *Income Tax Act* and is not required to accept a valuation prepared by the promoter or its appraiser;**
- ensure the arrangement is registered as a **tax shelter**;
- while **advance income tax rulings** are optional, determine if one was obtained by the promoter with respect to the particular donation arrangement and if so, obtain a copy and review it carefully; and
- **before signing** any documents, get competent and independent advice from a **professional tax advisor**.

Tax Shelter Amendment

A tax shelter is defined in the *Income Tax Act* to include any property or gifting arrangement for which a promoter represents that an investor can claim deductions or credits which equal or exceed the cost of the property less certain benefits within a four year period. The amendment to include gifting arrangements was effective February 19, 2003. Any subsequent arrangements that promise that donation tax credits will exceed the cost will be **tax shelters**, and promoters must obtain a **tax shelter number** before selling them. Taxpayers will be denied tax benefits if they participate in tax shelter arrangements that do not have a tax shelter identification number.

A **tax shelter number** is used for **identification purposes only**. It enables the CCRA to identify all tax shelters and their investors but offers **no guarantee** that taxpayers will receive

the proposed tax benefits. The CCRA reviews all tax shelters to ensure that the tax benefits being claimed meet the requirements of the *Income Tax Act*.

Audits of Donation Arrangements

When a taxpayer's return is first received, only a limited review of the return and accompanying statements is performed before issuing a Notice of Assessment. This approach is consistent with the Canadian self-assessment system of taxation but it does not imply that CCRA has accepted the return as filed. To maintain the integrity of the self-assessment system, the return may be selected for further review or detailed audit after the initial assessment. Certain types of deductions, like charitable donations, are more efficiently covered by a post-assessing review or audit.

The CCRA has reassessed about 5,000 individuals involved in donation arrangements for prior years. Some of these individuals have filed notices of objection and appeals to the tax court. Currently audits are being conducted on another 5,000 individuals involving various donation arrangements.

Penalties

There are a number of penalties that may be applied to people involved with these tax shelter arrangements:

- **Individuals:** The CCRA will disallow or adjust claims where it finds that the donation was not a true gift, or that the value of the donated property was inflated. This could cause you to lose part or all of the tax credit. Whether penalties will be applied in a particular situation depends on the facts and circumstances of the taxpayer's case. They may be applied in those situations where donors knowingly accepted and did not question appraised values far in excess of the cost of the property. The CCRA weighs such things as the amount and nature of the understated income, the individual's knowledge of tax matters, and the degree to which the individual participated in preparing his or her return.
- **Third parties (e.g. promoters, appraisers, charities, preparers.):** Effective June 29, 2000, third parties are subject to civil penalties for making misrepresentations in respect of tax matters that could result in their clients making false statements or omissions on their returns which includes overstating the fair market value of a property donated.

These penalties are based on the amount of tax evaded and the gross revenues earned by the third party providing information or services to taxpayers. For more information, see [Information Circular 01-1, Third-Party Civil Penalties](#).

Third Party Penalties can apply to promoters, advisors, charities or other institutions if they knew, or would reasonably be expected to know but for circumstances amounting to culpable conduct, that the appraised values were too high.

Culpable conduct refers to conduct (an act or a failure to act) that is tantamount to intentional conduct, shows an indifference as to whether the *Income Tax Act* or *Excise Tax Act* is complied with, or shows a wilful, a reckless or a wanton disregard of the law.

- **Registered Charities and Registered Canadian Amateur Athletic Associations (CAAA):** In addition to third-party civil penalties, a charity or CAAA could lose its registered status.
- **Tax shelter promoters:** Promoters who sell tax shelters before getting a tax shelter number are liable to a penalty equal to the greater of either \$500 or 25% of the money received for selling the tax shelter. The same penalty applies for filing false or misleading information on an application for a tax shelter number. No person may claim tax shelter benefits if a promoter is liable for such a penalty or interest on such a penalty.

The CCRA may ask taxpayers to support their claim with receipts, and may challenge transactions that have one or more of the following characteristics:

- the advertised arrangements promise to sell items (such as art, software, or pharmaceuticals) to taxpayers to be donated immediately to selected charities for tax receipts that are much higher than what the person paid;
- the appraiser is not acting independently of the promoters or sellers of the arrangement or the charities involved;
- the fair market value seems too high;
- where the arrangement involves a loan where it's unlikely the person has to repay the loan because the lender's recourse to collect is limited, or the provision to settle the loan is by way of something other than cash payment from the taxpayer.

Fact sheets on art donation arrangements were issued in December 1999 and November 2002.

For more information:

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