Vern Krishna: Why leveraged donation tax schemes can get lawyers in trouble

VERN KRISHNA | August 19, 2015 | Last Updated: Aug 19 6:49 AM ET
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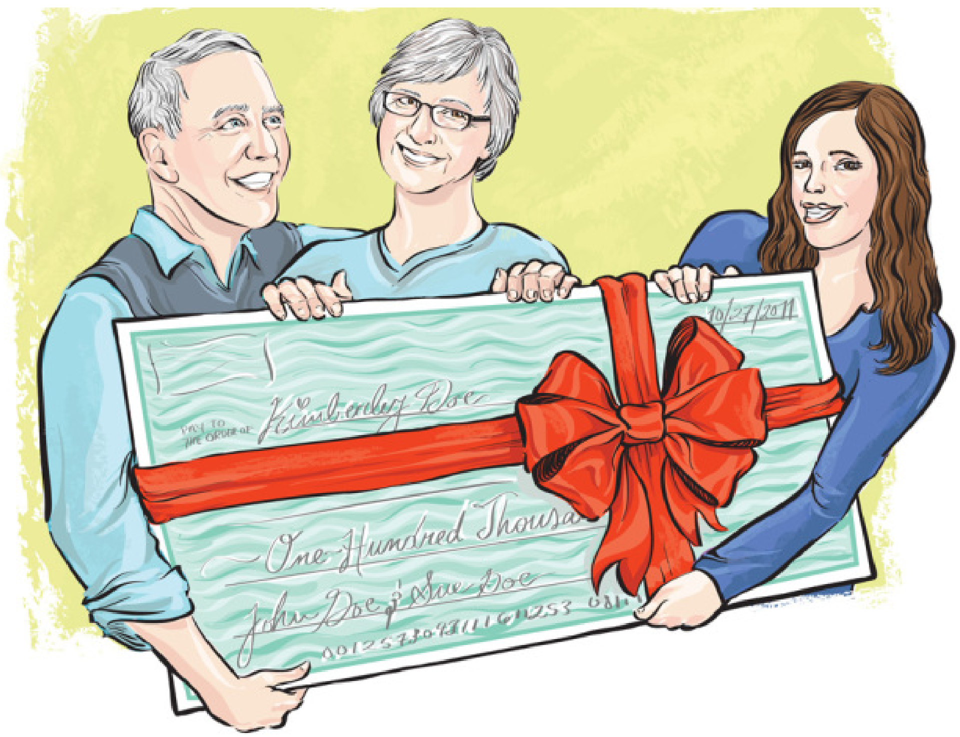

Illustration by Chloe Cushman/National Post

A recent Supreme Court of Canada case called Guindon is a warning to tax advisors: Take your duties seriously and think carefully before you step forward to provide any opinions saying that proposed charitable gifts comply with Canadian law.

The Supreme Court upheld administrative penalties of $546,747 imposed against a tax advisor under section 163.2 of the Income Tax Act by the Canada Revenue Agency. The advisor must pay the piper because she didn't provide proper advice on charitable gifts.

At the heart of the matter is the definition of "gift" for tax purposes. If advisors are going to certify that charitable gifts are proper, they need to analyze these things properly.

The Income Tax Act does not define the term "gift" for tax purposes, but the common law supplies some requirements.

At common law, a gift is the voluntary transfer of property from a donor to a donee for which the donor receives no benefit or consideration, and is a transfer without expectation of economic reward or material return. The donor must impoverish himself or herself by the transfer. Thus, the essence of a gift is a transfer motivated by detached and disinterested generosity.

The law identifies four key elements to a "gift": The donor must own the property that is given away; The donor must transfer the property voluntarily; no consideration can flow to the donor in return for the gift; and the subject of the gift must be property and not a service.

When the issue is a charitable gift, for tax purposes the overarching consideration is whether the taxpayer had an intention to donate the property to the charity. Those words, "intention to donate," depend upon the facts of the arrangement, and are intrinsic to the notion that the transfer of the property must "impoverish" the donor.

To put this in simpler terms, if you're truly giving a gift, you should be financially poorer after you've given the gift away. If you expect equal value in return, you're not really giving a gift.

In a case called Burns, for example, the court found that a taxpayer's payments to the Canadian Ski Association were not gifts, but were made to secure "a material advantage" for the taxpayer; namely, to train his daughter as a skier. The court said: "The donor must be aware that he will not receive any compensation other than pure moral benefit; he must be willing to grow poorer for the benefit of the donee without receiving any such compensation."

The concepts of "impoverishment" and "donative intent" are closely linked. There is an element of impoverishment, which must be present for a transaction to be characterized as a gift.

That said, recent amendments to the Income Tax Act have changed the "impoverishment rule" to permit tax credits where the donor obtains partial value in exchange.

Now, you might be wondering about tax receipts. If you're not supposed to receive anything in return for a gift, how is it that you can receive a tax receipt and claim the appropriate deduction on your taxes? Isn't that receiving a benefit in return?

The law recognizes this. Subject to the recent amendments to the Income Tax Act, the requirement that the donor not receive material advantage does not preclude an individual from obtaining a tax credit in exchange for his or her donation.

The fundamental purpose and policy of the tax credit is to provide a material cash incentive to donate to worthy causes. Hence, the tax advantage that the donor receives from his gift is not normally considered a "benefit," because doing so would render the charitable donations deductions unavailable to many donors. However, a donor's expectations that the donee will use his or her donation in a particular manner do not negate the character of the donation as a gift.

For example, an individual who donates art and jewelry to a charity will be considered to have the requisite donative intent, even though her primary motivation is to receive a tax advantage. The tax advantage is not a disqualifying benefit.

This brings us to the issue of those leverage donation tax schemes that are so often getting people in trouble with the CRA. The agency is increasingly vigilant with charitable donations to determine whether individuals are making genuine gifts, or merely seeking inflated tax breaks that go with them.

Although an individual is entitled to take advantage of the tax credit, the magnitude of economic material benefit from the donation itself can sometimes suggest the absence of donative intent. The anticipation of substantial material benefit can invalidate a donation, even where the donor is under no legal obligation to contribute.

That's precisely why one must be extra vigilant of supposed leveraged donation schemes. The courts have warned that taxpayers should avoid schemes that sound "too good to be true."

Guindon changes the rules of the game for lawyers and accountants who give legal tax opinions. Those who haven't paid attention to the rules in the past had best learn what a gift is in law.

Vern.Krishna@TaxChambers.ca
taxchambers.ca

Vern Krishna, is a professor with the University of Ottawa Law School and is counsel with TaxChambers LLP in Toronto.