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Canada

# Donor Beware

Investigation into the sufficiency of the Canada Revenue Agency's warnings about questionable tax shelter schemes

Ombudsman special report, December 2013 | J. Paul Dubé, Taxpayers' Ombudsman

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## TAXPAYER BILL OF RIGHTS

1. You have the right to receive entitlements and to pay no more and no less than what is required by law.
2. You have the right to service in both official languages.
3. You have the right to privacy and confidentiality.
4. You have the right to a formal review and a subsequent appeal.
5. You have the right to be treated professionally, courteously, and fairly.\*
6. You have the right to complete, accurate, clear, and timely information.\*
7. You have the right, as an individual, not to pay income tax amounts in dispute before you have had an impartial review.
8. You have the right to have the law applied consistently.
9. You have the right to lodge a service complaint and to be provided with an explanation of our findings.\*
10. You have the right to have the costs of compliance taken into account when administering tax legislation.\*
11. You have the right to expect us to be accountable.\*
12. You have the right to relief from penalties and interest under tax legislation because of extraordinary circumstances.
13. You have the right to expect us to publish our service standards and report annually.\*
14. You have the right to expect us to warn you about questionable tax schemes in a timely manner.\*
15. You have the right to be represented by a person of your choice.\*
16. You have the right to lodge a service complaint and request a formal review without fear of reprisal.

*\*Service rights upheld by the Taxpayers' Ombudsman*

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## Report Summary

Canadian registered charities are a major economic and social force that contributes to society through the active engagement of citizens. While corporations also play an active and important role in supporting charities, this report will focus on individuals. A donation made by an individual to a registered Canadian charity will result in a tax credit in the tax year it is claimed, based on the value of the gift or donation. The donor may choose to claim a tax credit based on all or part of the donation on his tax return for the year of donation or in any of the five following years.

Over the past several years programs claiming either to be charities, or associated with charities, have been marketed in Canada offering taxpayers the opportunity to contribute to their programs in exchange for official donation tax receipts several times higher than the amount contributed, resulting in tax credits greater than the amount the donor is out of pocket.

These programs are called tax shelter donations schemes and they generally work in the following way: a donor pays a certain amount to a promoter and receives an official donation receipt from a registered charity for an amount several times higher than the amount the donor paid. The donor then claims a tax credit based on the inflated donation amount on the receipt as a credit on their tax return, most often generating a large refund which ends up being much more than the amount they actually disbursed for the donation.

The Canada Revenue Agency (CRA) has reduced or disallowed claims for these types of donations sometimes even disallowing the actual amount paid by the donor. Why? Because the CRA determined that the donations claimed were not true gifts according to the law. Generally, to qualify as a “gift”, there must be no expectation of receiving anything in return; however, recent legislative amendments provide that a donor may, in certain circumstances, receive something in return and still qualify as a gift. As a result, the donor’s return is reassessed, the charitable donation claim is disallowed, and the taxpayer is required to pay the tax difference and reimburse any refund received plus accrued interest from the date that the refund from the CRA had been issued and/or tax was deemed as owing.

Furthermore, in some cases the CRA may impose a gross negligence penalty which is the greater of \$100 or 50% of the understatement of tax and overstatement of credits related to the false statement or omission, plus interest.

The CRA has been warning Canadians for the last fifteen years of the consequences of participating in abusive tax shelters that it holds to be non-



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compliant with the *Income Tax Act*. There is a substantial amount of information on the CRA's website and the CRA has published information, including warning about tax shelters and donating wisely, in a variety of newspapers, magazines and various other media sources. Yet people continue to be persuaded to participate in tax shelter donation schemes.

The Office of the Taxpayers' Ombudsman has received many complaints from donors whom the CRA had found to be participating in abusive tax shelter donation schemes. The donors alleged that they were unaware of the tax consequences when they participated in the tax shelter donation scheme. They also alleged that the CRA provided insufficient information to warn them of the consequences. According to the *Income Tax Act*, the CRA has three years from the time an individual's return is assessed to determine whether credits or deductions resulting from an investment in a tax shelter are legitimate. As a result, many donors had been participating in a tax shelter for a few years before the CRA completed its audit and determined that the tax shelter was not operating in accordance with the law. The CRA then reassessed the donors' tax returns to deny their donation claims. As a result, the donors were required to repay any refunds they received, as well as penalties and interest if applicable. As many donors had been participating in more than one year, this often resulted in very large debts owing to the CRA.

Our investigation revealed that despite the changes in legislation to combat these schemes, abusive tax shelter donation schemes continue to taint the charitable sector, and despite efforts by the CRA to warn Canadians of the consequences of participating in such schemes, it is still seeing abusive schemes operating to which donors contribute, either knowingly or unknowingly. As one donor stated, "We thought that sending medication to Africa to help the people who can't help themselves is a great donation program...also, we were told that the programs are 100% compliant with tax laws."

Confusion often arises because the donor is unclear as to the distinction between a tax shelter promoter and a registered charity. Tax shelter promoters often have names that may suggest they are registered charities but in fact, they are separate entities.

In this report, the Ombudsman makes a number of recommendations intended to address these problems and alleviate their impact on Canadians. The Ombudsman recommends additional measures be taken by the CRA in communicating warnings to the public about tax shelter donation schemes. The Ombudsman also recommends that the CRA monitor trends in the structuring of, and investing in, questionable tax schemes and make such information publicly available as soon as possible.



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## Glossary

### What is a registered charity?

Charities in Canada are defined as a charitable organization, public foundation, or private foundation that was established in Canada and is resident in Canada. It is operated exclusively for charitable purposes, i.e., the relief of poverty, the advancement of education, the advancement of religion, or other purposes that benefit the community in a way the courts have said are charitable. Organizations interested in applying for charitable registered status with the CRA must submit an application for registration; it is reviewed to ensure that the organization will comply with the legislation. A registration number is issued which allows the charity to provide official donation receipts. Registered charities have certain obligations under the *Income Tax Act*. Generally, the CRA works to facilitate voluntary compliance through education and information activities; website; outreach program; client service program; and reminder letters.

### What is a tax shelter?

A tax shelter is generally defined as an investment in a property or a gifting arrangement for which a promoter represents that an investor or donor can claim deductions or credits that equal or exceed the net costs of entering into the arrangement or purchasing the property. A tax shelter also includes a gifting arrangement where the donor borrows money to make the gift, knowing that the money will never have to be repaid.

### Examples of the common tax shelter arrangements:

- Gifting trust arrangements: An individual donates \$3,000 cash to a charity and then "receives" property (art, photography, medicines, software, etc.) with a purported "fair" market value of \$7,000 from a trust. The property from the trust is then also donated to a charity. The individual receives a \$10,000 donation receipt, which is then claimed on their income tax return. The individual never takes possession of the property.
- Leveraged cash donations: An individual borrows \$8,000 (from the organization involved in the scheme) to donate to a charity and donates \$2,000 out of pocket to the charity and receives a \$10,000 donation receipt. There is usually no expectation that the "loan" be repaid.
- Buy low, donate high arrangements: An individual buys property for \$3,000 and donates it at an inflated "fair market value" of \$10,000. The individual receives a \$10,000 donation receipt but never takes possession of the property.

In the three examples of typical donation tax shelters, the taxpayers receive an official donation tax receipt that is higher than the actual cash disbursed, thus 'profiting' from the donation.

## Introduction

Charities help with the relief of poverty, the advancement of education, the advancement of religion, or other purposes that benefit the social well-being of communities. Currently there are approximately 86,000 federally registered charities in Canada. The CRA is responsible for ensuring that charities comply with the requirements of the *Income Tax Act* such as registration, reporting of activities, filing statements of assets and liabilities, or other administrative requirements. The CRA administers a system to register charities under the *Income Tax Act*. As such, the CRA's responsibilities include:

- Processing applications for registrations;
- Offering technical advice on operating a charity;
- Ensuring compliance with the *Income Tax Act* obligations; and
- Providing general information to the public.

Registration provides charities with exemption from income tax. Registration also authorizes charities to issue official donation tax receipts for income tax purposes, meaning that donors can claim gifts made to registered charities to reduce their income tax.

In 2003, the CRA began to look closely at tax shelter donation schemes, which were growing in numbers. The CRA saw a spike in tax receipts for tax shelter donations being submitted with tax returns in 2006. Since then, there has been a decline in participation in these tax shelter donation schemes. However, participation is still widespread and continues to have a negative impact on the charitable sector and ultimately on taxpayers who may find themselves with a large tax liability and no means to pay it as their tax refund has long been spent.

To date, every tax shelter donation scheme audited by the CRA has been found to be in contravention of the *Income Tax Act*. When a scheme does not comply with the *Income Tax Act*, the CRA will deny any claim for a charitable donation tax credit related to that scheme. This denial has a significant impact on many donors. If a donor has already submitted a tax return based on participation in that scheme, and the return has been assessed, the donor's tax return will be reassessed by the CRA to deny the charitable donation claim. Subsequently, the donor will be required to repay any refund they may have obtained from the CRA as a result of the claim, and pay any outstanding tax amounts as well as substantial interest and applicable penalties. In many cases this results in the participants owing tens of thousands of dollars.



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The CRA has released many warnings against tax shelter donation schemes, through communication product such as: its website, publications, public notices and mail outs. Other Canadian organizations, such as the Canadian Cultural Property Export Review Board<sup>1</sup> and the Canadian Council of Christian Charities<sup>2</sup> have also put warnings on their websites advising caution when presented with proposals to participate in tax shelter gifting arrangements for cultural property.

Despite many warnings from the CRA and reports from the media and other organizations, Canadians are still investing in these schemes. The prospect of paying less tax may be a strong motivation for some. For others, the motivation is the potential for a large tax refund. However, some participants have stated that they truly believed the claims of the promoters that their donations would be to help others. Unfortunately, many subsequently faced financial hardships once their tax returns were reassessed with penalties and interest added to the amount owing.

## Issue

The Office of the Taxpayers' Ombudsman (OTO) continues to receive complaints from participants who feel that the CRA has not sufficiently warned them of the dangers of participating in tax shelter donation schemes, or has not warned them in a timely manner that the scheme they had been participating in was questionable.

Despite their claims of innocence, we concluded that some donors have knowingly participated in questionable schemes in order to receive an inflated tax refund. Others may have honestly thought that the tax shelter was legitimate and approved by the CRA, and been caught in the scheme because of the “proof” provided by the tax shelter promoters that the schemes were legal and legitimate. As one complainant stated, “We thought that sending medication to Africa to help the people who can’t help themselves is a great donation program...also, we were told that the programs are 100% compliant with tax laws.”

The price to pay for participating in a tax shelter donation scheme can be quite substantial for donors. If the CRA determines that a tax shelter is not operating in accordance with the *Income Tax Act*, donors can find themselves owing large amounts to the CRA, often tens of thousands of

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<sup>1</sup> “CCPERB Advisories”, Canadian Cultural Property Export Review Board, accessed September 24, 2013, <http://www.pch.gc.ca/eng/1347044424978/1347045197980>.

<sup>2</sup> “Tax Shelters and Tax Schemes”, Canadian Council of Christian Charities, accessed September 24, 2013, [http://www.cccc.org/members\\_topic\\_show/tax\\_shelters\\_and\\_tax\\_schemes](http://www.cccc.org/members_topic_show/tax_shelters_and_tax_schemes).



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dollars, for repayment of refunds they were never entitled to plus penalties and interest.

Some donors who had been contributing to tax schemes for several years and claimed they did not realize they were not compliant with the *Income Tax Act*, complained that the CRA had not done enough to warn them in a timely manner so that they could avoid repeating their mistake year after year. Many complainants were either close to retirement or already retired and stated that the debt they were facing impacted greatly their finances and their ability to enjoy retirement.

The CRA has been posting warnings to taxpayers about tax shelters in general since 1998 and donation schemes since 2003.

Whether their actions are wilful or unintentional, individuals and charities are continuing to get caught up in tax shelter donation schemes not in compliance with the *Income Tax Act*. Article 14 of the *Taxpayer Bill of Rights* states that taxpayers have the right to expect the CRA to warn them about questionable tax schemes under scrutiny by the CRA in a timely manner.

However, the CRA can only warn taxpayers about tax schemes after they become aware of them and have determined that they may be questionable.

Article 6 of the *Taxpayer Bill of Rights* requires that the CRA provide the information completely, accurately, clearly, and in a timely manner. With the information available from the CRA and other sources, why are taxpayers and charities still getting caught in these schemes? Is there more the CRA should do to better inform taxpayers? These are some of the key questions raised during our investigation.

## **Mandate of the Taxpayers' Ombudsman**

An ombudsman is an independent and impartial officer who deals with complaints about an organization. An ombudsman provides an impartial review of complaints and determines whether or not the complaint has merit. After reviewing the complaints, the Ombudsman advises the parties of the conclusion. When a complaint suggests that there may be a systemic problem that could negatively affect multiple stakeholders, an ombudsman typically makes recommendations for corrective action.

The Taxpayers' Ombudsman was appointed to support the government priorities of stronger democratic institutions, increased transparency within institutions, and the fair treatment of all Canadians.



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The Taxpayers' Ombudsman is mandated to provide advice to the Minister of National Revenue on service issues within the CRA. This is why the Ombudsman makes recommendations on systemic issues directly to the Minister.

The Taxpayers' Ombudsman fulfills this mandate by reviewing service complaints from taxpayers about the Canada Revenue Agency, informing Canadians about their rights as taxpayers, upholding the eight service rights within the *Taxpayer Bill of Rights*, and identifying and reviewing systemic issues and emerging trends related to service matters.

Of the eight service rights the Taxpayers' Ombudsman is mandated to uphold, the four rights relevant to this systemic investigation are:

- The right to be treated professionally, courteously and fairly (Article 5).
- The right to complete, accurate, clear and timely information (Article 6).
- The right to expect (the CRA) to be accountable (Article 11).
- The right to be warned about questionable tax schemes in a timely manner (Article 14).

## What We Heard

### ***Ms. C's story - Early warnings needed<sup>3</sup>***

Ms. C had donated to a registered charity in 2004, 2005 and 2006. In July 2007, Ms. C received a letter from the CRA to advise her that her 2004 donation to the charity was being disallowed, since the CRA determined that the donation was a “gifting arrangement” made through a tax shelter found to be non-compliant with the *Income Tax Act*. The letter provided information regarding the CRA’s position based on the audit of the tax shelter. Ms. C subsequently filed a notice of objection with CRA’s Appeals Branch and in March 2008, she received a letter saying that her objection was being held in abeyance pending the conclusion of the review of related objections. In September 2008, Ms. C received a letter disallowing her 2005 donation. In November 2008, she received another letter disallowing her 2006 donation.

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<sup>3</sup> All names have been changed to maintain confidentiality.



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In January 2009, we received a complaint from Ms. C stating that she wished that she had been advised sooner that her donation was not in compliance with the *Income Tax Act*. She found herself with a large tax debt just before her retirement. She felt that donors should be warned earlier in the process when the CRA conducts an investigation into a tax scheme.

Ms. C claimed that she didn't have a computer at home and was unable to check for any warnings about tax shelters online, and said she would have had to rely on other methods to find information on tax shelters.

During the course of our investigation, our Office communicated Ms. C's concerns along with a suggestion that the CRA include a warning about tax shelter donation schemes in its tax guides. The CRA responded that it would include a link to the webpage, as well as a link to tax alerts and more information about the subject in its tax guides.

#### ***Mr. D's story - Three-year delay***

When Mr. D submitted a complaint to our Office in January 2010, he stated that he had been waiting since August 2007 for the completion of an audit and the reassessment of his 2006 tax return. He found the delays he was experiencing for the reassessment unacceptable.

Our investigation revealed that in 2004, Mr. D participated in a leveraged cash donation scheme, in which a donor borrows money from the organization involved in the scheme and donates, out of pocket, a small amount. The donor then claims the out-of-pocket expense plus the "loan" as a charitable tax credit. In 2005 and 2006, Mr. D participated in a gifting trust arrangement scheme. In November 2006, Mr. D received a letter from the CRA regarding the 2004 tax year and was advised that the reviews of tax shelters could be lengthy and are dependent on the cooperation of the tax shelter under review. The CRA also advised him that the CRA has up to three years to reassess the tax returns. In September 2008, Mr. D received another proposal, this time for the 2005 tax year.

In December 2009, Mr. D received a proposal from the CRA for the 2006 tax year. The CRA explained that the audit for the 2006 tax year was taking longer than other years because in this instance the lead audit (the audit of the tax shelter scheme) had proven to be complicated. There were many more donors involved in this particular tax shelter scheme than the others he had been involved in, which in turn lengthened the audit. Mr. D was also advised of the recourse available to him such as submitting a notice of objection to the Appeals Branch and our Office recommended he apply for relief of interest and penalties.



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Mr. D felt that if the CRA had informed him of the repercussions of participating in a tax shelter sooner than the three years it took, he would not have continued to participate in the tax shelter in the following years. Mr. D felt that the CRA failed to give him complete, accurate and timely information regarding this situation. He stated that he understood from the letters he received from the CRA that the information was available online, but he claims he did not have access to the Internet during the years he contributed and was therefore unable to access the information.

#### ***Ms. E's story - Trusting a promoter***

Between 2000 and 2003, Ms. E participated in a software tax scheme for which she received tax receipts for five times the amount of her cash donations. In April 2004, the CRA disallowed Ms. E's donation amounts for tax years 2000 and 2001. In July 2004, the CRA advised Ms. E to pay the outstanding amount since interest would continue to accumulate as long as the debt was not paid.

In October 2004, the CRA disallowed her donations for the 2002 tax year and reassessed her 2002 tax return adding interest and gross negligence penalties. In May 2005, Ms. E was again advised to pay the outstanding amount to avoid accumulating more interest. In August 2006, the CRA disallowed the donations for 2003 and reassessed her 2003 tax return with interest and gross negligence penalties.

In October 2006, Ms. E received a letter from the CRA advising that her notices of objection would be held in abeyance pending the resolution of similar objections from participants in the same tax scheme. She was advised to pay the taxes owing to avoid more interests charges. She was also advised that if she paid the amount outstanding, in the event that her objection was allowed, the CRA would issue a refund to her plus interest.

In August 2007 the CRA sent a proposal to Ms. E, which she did not accept. In November 2009, she was advised again to pay the amount to avoid more interest charges. Finally in July 2010, the CRA sent a final proposal to Ms. E, cancelling the gross negligence penalties, which she accepted. Our involvement in the file ended after Ms. E accepted the CRA's proposal.

Ms. E complained to our Office in June 2011 that she and her husband had been unaware of the consequences of investing in a tax scheme and now they were facing a large debt which was substantially affecting their retirement funds. They had trusted the promoter, and had friends who trusted him. She said the promoter had shown her he had over 3,500 customers which included doctors and lawyers and she had verified that he was a chartered accountant. She asked, "If they did not know he was a



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crook, how could we possibly know?” The promoter had brochures that specified that all the information had been reproduced directly from the CRA’s website, thus giving them a false sense of security.

Ms. E found that a 10-year delay in processing three years of income tax returns was unreasonable. However, audits into tax shelters are complicated and lengthy. In Ms. E’s case, there were many other taxpayers involved in the same scheme; thus, the CRA held her objections in abeyance pending resolution in Tax Court of cases related to the same tax scheme.

## The Scope of our Review

Our investigation looked at how the CRA warns and educates taxpayers, in all segments of the population, to dissuade them from investing in tax shelter donation schemes and to ensure compliance.

We asked: Is the CRA meeting its obligations pursuant to the *Taxpayer Bill of Rights* to warn Canadians of questionable tax schemes?

While the CRA has an obligation to protect the tax base, and to detect and prosecute fraud, it also has an obligation to warn taxpayers about questionable tax schemes. The role of the Ombudsman is to uphold such taxpayer rights.

## Charities Defined

### ***What is a charity?***

The Oxford English Dictionary defines a “charity” as “an organization set up to provide help and raise money for those in need.”<sup>4</sup>

A charitable organization is a type of non-profit organization that centers on philanthropic goals, engaging in activities serving the public interest or common good.

For tax purposes, charitable foundations and organizations are defined in s. 149.1(1) of the *Income Tax Act*. A charitable foundation is a corporation or trust that is constituted and operated exclusively for charitable purposes, where no part of the income is payable to, or is otherwise available for, the

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<sup>4</sup> “Definition of charity in English”, Oxford Dictionaries, accessed September 24, 2013, <http://oxforddictionaries.com/definition/english/charity?q=charity>.



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personal benefit of any proprietor, member, shareholder, trustee or settlor thereof. A charitable organization is an organization, whether incorporated or not, where all the resources are devoted to charitable activities carried on by the organization itself.

### ***What is a registered charity?***

Charities in Canada must register with the CRA. The CRA defines a registered charity as a charitable organization, public foundation, or private foundation that was established in Canada and is resident in Canada. It is operated exclusively for charitable purposes (i.e. the relief of poverty, the advancement of education, the advancement of religion, or other purposes that benefit the community in a way the Courts have said are charitable) and must devote its resources to charitable activities. A registered charity receives a registration number from the CRA and is exempt from paying tax on its income. It can issue official donation receipts for income tax purposes for gifts that it receives.<sup>5</sup>

#### **Statistics:**

- Number of registered charities: 86,618 (as of August 12, 2013)
- Number of charitable applications received annually: 4,000
- Number of charities registered annually: 2,750
- Number of registration revoked annually: 1,800 (for various reasons)
- Number of registered charities audited annually: 900
- Number of charities known to have been involved in tax shelters: approximately 85
- Number of charities revoked or annulled for participating in tax shelters since 2003: 47
- Number of charities currently under audit for participating in tax shelters: 11

#### **Statistics provided by the CRA**

Note: charities who were not revoked or annulled remain registered yet audits were conducted and resulted in the issuance of an education letter or compliance agreement or had their applications for registered charity status refused or withdrawn.

<sup>5</sup> "Donation and donors – Questions and answers", Canada Revenue Agency, accessed September 24, 2013, <http://www.cra-arc.gc.ca/chrts-gvng/dnrs/fq-eng.html#q1>.



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## **What is a tax shelter?**

The CRA bases its definition on the *Income Tax Act*, and according to the CRA:

A tax shelter is generally defined as any property<sup>6</sup> or gifting arrangement for which a promoter represents that an investor can claim deductions or credits that equal or exceed the cost of the property less certain benefits within a four-year period. Also, a gifting arrangement where the donor incurs a limited-recourse debt related to the gift will be a tax shelter. Generally, a limited-recourse debt is a debt where the borrower is not at risk for the repayment.<sup>7</sup>

A promoter of a tax shelter is a person who:

- sells, issues, or promotes the sale, issuance or acquisition of, the tax shelter;
- acts as an agent or adviser in respect of the sale or issuance, or the promotion of the sale, issuance or acquisition, of the tax shelter; or
- accepts, whether as a principal or agent, consideration in respect of the tax shelter. More than one person may be a tax shelter promoter in respect of the same tax shelter.<sup>8</sup>

Tax shelters are required to obtain a tax shelter identification number from the CRA. This number is used by the CRA to identify the tax shelter, the promoters and its investors, but it does not guarantee that contributors will receive the proposed tax benefits from investing. It is not a registration number confirming acceptance or approval. In fact, tax shelter numbers were introduced in 1989 in order to facilitate identification of tax shelter schemes and enforcement of the ITA.

A tax shelter is abusive when its scheme goes beyond what the law allows; specifically when a participant will “profit” from a donation, meaning that they will receive a tax credit and refund that is greater than their out-of-pocket donation. To date, all participants who invested in tax shelters that have promoted such profit and avoidance of taxes have been denied their claim.

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<sup>6</sup> A ‘property’ is defined in the legislation and includes any tangible or material asset.

<sup>7</sup> Charities and Giving Glossary, Canada Revenue Agency, accessed September 24, 2013, <http://www.cra-arc.gc.ca/chrts-gvng/chrts/glossry-eng.html>.

<sup>8</sup> *Income Tax Act* s. 237.1 Justice Laws website, accessed September 24, 2013, <http://laws-lois.justice.gc.ca/eng/acts/I-3.3/page-402.html#docCont>.



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# Regulation of Charities and Tax Shelters

## *Registration of Charities*

The CRA administers the registration of charities under the *Income Tax Act*. As the regulator of charities, the CRA's responsibilities include:

- processing applications for registration;
- offering technical advice on operating a charity;
- handling audit and compliance activities; and
- providing general information to the public.

Charitable organizations request registration by completing the Form T2050, *Application to Register a Charity Under the Income Tax Act*<sup>9</sup>, and sending it to the CRA. The organization applying for registration must also include a governing document, a detailed description for each of its activities, and financial information such as the proposed operating budget of revenue and expenditures for a 12-month period as well as a list of anticipated assets and liabilities. The organization must also provide information about each of the organization's officials, a certificate of good standing and a copy of by-laws if applicable.

If the organization is incorporated, the CRA requires official copies of the articles of incorporation, letters, patent and memoranda of incorporation with the seal or stamp of the federal, provincial or territorial authority.

Once the CRA has determined that the organization has exclusively charitable purposes and activities which support those purposes, the CRA registers it and provides a registration number. The charity is then exempt from paying income tax under Part I of the *Income Tax Act*.

Registration also authorizes charities to issue official donation receipts for income tax purposes which will have the charity's registration number as well as other prescribed information on it. The donors can then use the receipt to claim a credit on their income tax return in order to reduce their income tax payable, and possibly generate a refund.

Generally the CRA works to facilitate voluntary compliance through education and information activities: website; outreach program; client service program; and reminder letters.

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<sup>9</sup> T2050- *Application to Register a Charity Under the Income Tax Act*, Canada Revenue Agency, accessed September 24, 2013, <http://www.cra-arc.gc.ca/E/pbg/tf/t2050/t2050-11e.pdf>.



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Where concerns are identified, the CRA will use one or more of the following measures:

1. Education letters guide charities through the steps they need to follow to be fully compliant with their obligations;
2. Compliance agreements outline commit charities to take corrective action; and
3. Sanctions include financial penalties and temporary suspensions of charities' tax receipting privileges as well as their status as qualified donees.

Revocation is generally a last resort and is used only in the most serious cases of non-compliance with the Act.

### **Tracking tax shelters**

Tax shelters, on the other hand, do not go through a registration process. Tax shelters have to fill out a T5001, *Application for Tax Shelter Identification Number and Undertaking to Keep Books and Records*<sup>10</sup>, and the CRA provides them with a tax shelter identification number after verifying that all the information needed has been included. Donors are often confused by the “tax shelter identification number”, assuming the number means that the tax shelter has “registered” with the CRA, and gone through an approval process, when it has not. Tax shelter numbers are only for tracking purposes. In fact,

“When the donation was rejected, I talked to [the Canada Revenue Agency] and was told that a company having a [tax shelter] number is absolutely meaningless. Everyone can get that number just by asking for it. It is up to the participant to ensure that the program is compliant...How is a participant supposed to ensure that the program is compliant and the charity is legitimate?” - Complainant

paragraph 237.1(5)(c) of the *Income Tax Act* requires promoters to prominently display a specific “tax shelter statement” on every written statement that refers to the issuance of a tax shelter identification numbers. This caution makes clear to the reader that the “issuance of the identification number is for administrative purposes only and does not in any way confirm the entitlement of an investor to claim any tax benefits associated with the tax shelter.” The legislation ensures that investors are told clearly, and in the very material that is being presented by the promoter, that the issuance of a tax shelter number is no guarantee that the scheme will be accepted by the CRA.

The confusion continues in that tax shelter donation schemes are set up by deceitful promoters so that the donation programs look legitimate, promising

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<sup>10</sup>T5001-Application for Tax Shelter Identification Number and Undertaking to Keep Books and Records, Canada Revenue Agency, accessed September 24, 2013, <http://www.cra-arc.gc.ca/E/pbg/tf/t5001/>.



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aid to the needy and deserving through donations to registered Canadian charities. Worse, the promoters often use an existing, small or obscure registered and legitimate charitable organization to issue the receipts. The charity is promised a much larger amount of money than it could possibly raise itself, providing that the charity prepare the donation receipts for an inflated amount for each participant. In the end, the amount of money given to the charity usually represents no more than 1% of all the money raised by the promoters.

Legitimate charities are becoming involved in these tax schemes for various reasons:

- The charity is happy to receive the 1% of total donations – it is still a larger amount of money than it was able to raise in the past.
- The directors of the charity might believe the incredible claims of the promoters as to what is done with the donated money and property.
- The directors of the charity are convinced that the “loophole” or interpretation of the *Income Tax Act* by the promoter(s) is entirely legal.

#### ***What is aggressive tax planning and/or tax avoidance?***

Courts have recognized the long-standing principle that a person might order their affairs so as to attract the least tax liability. Effective tax planning occurs when a taxpayer takes advantage of lawful deductions and credits. Some examples of tax planning are RRSPs, whereby the taxpayer is not avoiding tax, but rather deferring the tax payable until a later date.

Aggressive tax planning arrangements<sup>11</sup> are often schemes that involve tax reduction arrangements that technically meet the rules of the relevant legislation but run against the overall spirit of the law. Tax avoidance often (but not always) involves a series of transactions which, taken individually, seem to comply with the law. Taken together, however, these transactions are contrary to the intent of the law.

In general, aggressive tax planning arrangements lack a genuine business purpose and are made for the primary purpose of avoiding the payment of the required taxes. Many tax shelter donation schemes have been found to exist for the sole purpose of avoiding the payment of taxes. Of the schemes the courts have considered thus far, they have generally regarded these tax shelter donation schemes as abusive tax planning.

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<sup>11</sup> “Tax Alerts- Aggressive Tax Planning”, Canada Revenue Agency, accessed September 24, 2013, <http://www.cra-arc.gc.ca/gncv/irt/>.

### **Charities registration number and tax shelter number: What is the difference?**

In order to be granted registered status, and therefore a registration number, organizations must demonstrate to the CRA that they have exclusively charitable purposes and activities, and will operate in accordance with the *Income Tax Act*. When the CRA is satisfied that the organization's charitable purpose is set up according to the legislation (meaning that it will provide relief from poverty, advance education, etc.), it will issue a registration number to the organization, granting it the privilege of issuing tax receipts for donations it receives.

A tax shelter, on the other hand, simply submits a form T-5001, *Application for Tax Shelter Identification Number and Undertaking to Keep Books and Records*, to obtain an identification number. The CRA will ensure that the form is filled out correctly and completely and that supporting documents are included (financial books, investments records, insurance policy, valuation and appraisal information, etc.). It will then issue an identification number. This number is for tracking purposes only. Should an audit be performed and the tax shelter is found to be contrary to what the legislation intended, the CRA will use the tax shelter information return to identify participants in the tax shelter. The CRA will review the tax shelter books and records and participant documents and reassess their income tax returns as needed. It is important to note that the tax shelter identification number does not in any way confirm the entitlement of an investor to claim any tax benefits associated with the tax shelter; it is for administrative purposes only.

## **Common Types of Tax Shelter Donation Schemes**

Generally tax shelter donation schemes sell or promote advantageous charitable donation receipts for donors. The donors then claim the donation receipts as a credit on their income tax returns, usually generating a tax refund larger than their out of pocket donation. Each scheme has its own complexities but they are all based on one principle: make a cash contribution and get a donation tax receipt that usually equals three to four times or more the actual amount contributed. A taxpayer can receive a tax credit<sup>12</sup> of 29% for amounts gifted over \$200<sup>13</sup>. As a tax shelter participant, a taxpayer generally receives an official donation receipt that is three or four times their actual out of pocket expense. When the taxpayer claims a tax

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<sup>12</sup> The credit is 15% on the first \$200 and 29% over that amount. For donations after March 20, 2013, qualifying first time donors may receive an additional federal tax credit of 25% on the first \$1,000 of donations, over and above the amounts indicated previously.

<sup>13</sup> This represents the federal credit and does not include the provincial credit.



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credit, he will claim an amount based on the total amount of donations identified on the donation receipt, resulting in the reduction of tax or even a tax refund greater than his out-of-pocket expense.

Promoters of such schemes attract participants by telling them that they have obtained legal opinions that the scheme is permissible under the law; they show participants notices of assessment and refunds others may have received. However, the CRA's legal interpretation may differ from the one obtained from a lawyer and an advance ruling may become non-binding if the details of the tax shelter being promoted differs, even slightly, from what was presented to the CRA.

According to the CRA, the three most common tax shelter donation schemes are gifting trust arrangements, leveraged cash donations, and buy-low, donate-high arrangements.<sup>14</sup> Some examples follow:

- **Gifting trust arrangements:** An individual donates \$3,000 cash to a charity and then "receives" property (art, photography, medicines, software, etc.) with a purported "fair" market value of \$7,000 from a trust. The property from the trust is then also donated to a charity. The individual receives a \$10,000 donation receipt (\$3,000 for their initial cash donation, and \$7,000 for the donation of the property), which they then claim on their income tax return.
- **Leveraged cash donations:** An individual borrows \$8,000 from the organization involved in the scheme to donate to a charity and donates \$2,000 out of pocket to the charity. The individual receives a \$10,000 donation receipt. There is usually no expectation that the "loan" be repaid.
- **Buy low, donate high arrangements:** An individual buys property for \$3,000 and donates it at a claimed "fair market value" (inflated value) of \$10,000. The individual then receives a \$10,000 donation receipt.

In all the examples, the taxpayers receive a tax refund or tax reduction that is higher than the actual cash disbursed, thus 'profiting' from the arrangement.

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<sup>14</sup> It is important to note that, in most cases, the taxpayer does not take ownership of the goods, but that the money and goods stay within the control of the promoter(s) and ends up being a circular financial transaction.

### ***Determining fair market value***

All tax shelter donation schemes involve some kind of asset that is purportedly donated. In the “buy low and donate high” types of schemes, the promoters of the scheme tell participants that they acquired an asset (art, medicines, software, etc.) at a low price and then had an “expert” evaluate the asset at a much higher price. This is higher than the actual fair market value. However, the CRA states that “normally the fair market value is the highest price, expressed in dollars that property would bring in an open and unrestricted market, between a willing buyer and a willing seller who are knowledgeable, informed, and prudent, and who are acting independently of each other.”<sup>15</sup>

According to the CRA:

the deemed fair market value rules at subsection 248(35) states that, under certain conditions, a receipt issued for a non-cash gift must be issued for the lesser of the gift's fair market value and its cost to the donor (or in the case of capital property, its adjusted cost base) immediately before the gift is made.

Example: A donor purchases a work of art for \$300, and six months later donates the work to a registered charity. The registered charity would like to issue the donor an official donation receipt. Prior to gifting the art, the donor has the work appraised at a value of \$1,000.

Because the donor is gifting the art within three years of having purchased it, the charity must issue a receipt for the gift at the lesser of its fair market value and its cost to the donor immediately before the gift was made. In this example the official donation receipt must be made out for \$300.

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<sup>15</sup> “Determining Fair Market Value”, Canada Revenue Agency, accessed September 24, 2013, <http://www.cra-arc.gc.ca/chrts-gvng/chrts/prtng/rcpts/dtrmnfmv-eng.html>.

### **Red flags**

Taxpayers considering investing in a tax shelter donation scheme would be well advised to watch for “red flags” such as the following:

- You are promised a tax receipt for much more than your contribution.
- There is little information about how the scheme works on the tax shelter’s website.
- The promoters refuse to answer questions until you hear their sales pitch.
- The promoters refuse to answer questions from the press.
- The promoters keep reassuring you that there is nothing to worry about in their scheme, which is purportedly different from similar schemes which were shut down by the CRA.
- You have never heard of the beneficiary party or the beneficiary party has a name similar to that of a legitimate, reputable organization.
- The promoters claim to have a tax opinion from lawyers. (In fact, an opinion is just that- an opinion - and it doesn’t guarantee anything.)
- You are pressured to sign right now without being granted the time to think about it or consult an *independent* financial advisor or tax lawyer.
- You are pressured to consult only the lawyer the promoter is suggesting.
- The promoters use the expression “...and it’s all perfectly legal.”
- The arrangement involves incredulous claims such as an unnamed individual has established a trust to distribute highly valued property to participants.
- The promoter knows very little about the beneficiary charity, its purposes, where it operates and so forth or provides very limited details about the beneficiary charity and how it will use the copious amounts of cash and property to be received from the taxpayer.
- It is difficult to find public recognition or announcements of the charity’s good works as a result of its tax shelter participation. Given that billions of medicine units have been purportedly distributed in Africa, why is it that no one in Canada or the charity’s donors are aware of its purported good deeds internationally?

- The promoter advises that the CRA will audit you and deny your donation claim but the promoter will take care of the CRA and will defend the scheme in court.
- The promoters tell you that if you lose when challenging the CRA, you can consider your tax refund a low-interest loan from the CRA. In reality, with compounding daily interest as well as penalties on a debt payable to the CRA over several years, the money owed grows exponentially. A significant net loss is the likely outcome.

***I have donated, now what?***

The CRA has consistently reduced or disallowed claims for these types of tax shelter donations schemes, including the actual amount paid by the donor.

Why? The CRA determined that donations claimed were not true gift in accordance with the law. As a result, the donor's return is reassessed, the charitable donation claim is removed, and the donor is required to pay the tax difference, any refund received, and accrued interest from the date that the refund from the CRA was issued or tax was deemed as owing.

Additionally, the CRA may impose a gross negligence penalty,<sup>16</sup> which is the greater of \$100 and 50% of the understatement of tax and/or overstatement of credits related to the false statement or omission, plus interest.

If the donor does not agree with the CRA assessment or reassessment of their income tax, or the issuance of a gross negligence penalty specifically related to the donations that were disallowed, they can file a notice of objection.<sup>17</sup> The CRA can reassess a return up to three years after the date of the initial assessment, and longer if it has evidence of fraud or tax evasion, negligence or misrepresentation, or reasonable grounds that it may have occurred. When the CRA suspects that a tax shelter is abusive, it may hold all objections relating to the specific organization, or others that are operating under similar circumstances, in abeyance pending the outcome of an audit or court case, which may take several years to be resolved.

Since the final resolution may happen many years after the initial tax returns were filed, especially if the taxpayer's objections were held in abeyance pending a court case, the amount of interest accrued on the amount owing and the penalty are often considerable.

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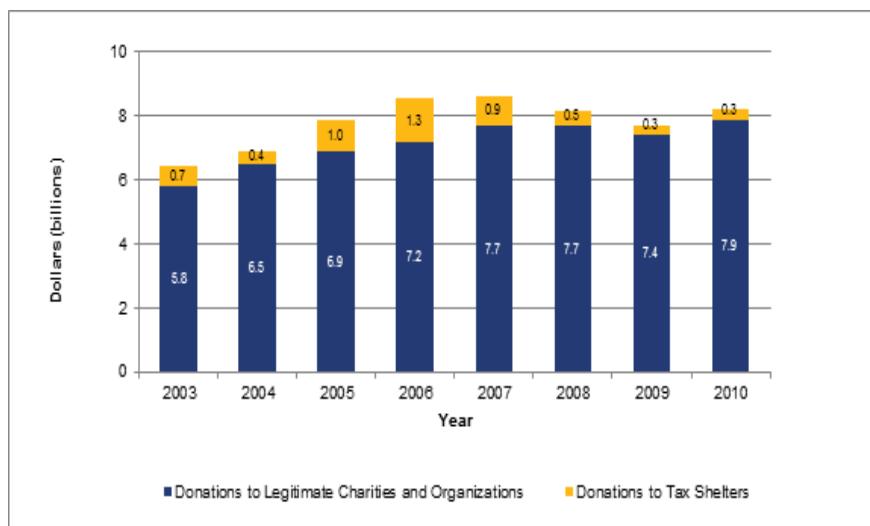
<sup>16</sup> "Interest and Penalties", Canada Revenue Agency, accessed September 24, 2013, <http://www.cra-arc.gc.ca/tx/ndvlls/tpcs/ncm-tx/nrst/menu-eng.html>. A false statement or omissions penalty, otherwise known as a "gross negligence" penalty, can be levied on an assessment if the taxpayer has knowingly, or under circumstances amounting to gross negligence, made a false statement or omission on their tax return.

<sup>17</sup> "T400A- Objection- Income Tax Act", Canada Revenue Agency, accessed September 24, 2013, <http://www.cra-arc.gc.ca/E/pbg/tf/t400a/t400a-12e.pdf>.



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Total Charitable Donations by Individuals to Legitimate Charities and Organizations and to Tax Shelters, Canada, 2003–2010 Taxation Years



Source: Department of Finance, Brief submitted to the House of Commons Standing Committee on Finance, 25 January 2012.

It is important to note that there are often delays in reassessing the tax returns because audits of tax shelter schemes are complicated and depend on the cooperation of the organization being investigated in providing all the information the CRA needs to conduct and finalize its audit. Further, it is beneficial to the tax shelter and charitable organization to delay as much as possible so that it can continue to sell the scheme. We have seen cases in which the promoter of a tax shelter scheme refused to comply with requests from the CRA to provide books, records and other documentation. In these cases, the CRA experienced delays in its audit because it had to request legal advice and ask the Department of Justice to obtain a Compliance Order. This, in turn, delayed reassessments of the tax shelters' participants.

The CRA cannot divulge specifics of an ongoing audit due to the confidentiality provisions of the *Income Tax Act*; for example, the CRA is unable to warn donors that the specific tax shelter or charitable organization they have invested in is being reviewed for possible non-compliance. Although this frustrates many donors enormously (as most complainants told us), there is not much the CRA can do except try to complete its audit as quickly as possible. Upon the finalization of a charity audit, the CRA issues a press release and makes available, upon request, copies of letters issued to registered charities, wherein their registered status has been revoked as a result of participation in a gifting tax shelter scheme. The CRA's letters contain the name of the gifting tax shelter which the charity participated in.

Starting with the 2012 tax year, the CRA has implemented a new national policy whereby it will not process tax returns that claim credits related to gifting tax shelters schemes. These returns will be held in abeyance pending an audit of the gifting tax shelter. The CRA will process the tax return only if the donor chooses to remove the donation amount and wait for the outcome of the audit. This process is intended to reduce the number of inflated refunds that are issued, which are later recovered from the donor, plus penalties and interest. Should the taxpayer remove the donation amount and the tax shelter is found to be valid, they can reinstate their claim which will be refunded with interest. We must reiterate that to date no tax shelter gifting arrangement has been found by the CRA or a court of law to be valid.

### ***Encouraging compliance***

In order to better monitor the activities of tax shelters, in March 2012 the CRA began issuing tax shelter identification numbers that are valid for one calendar year only. Any tax shelter identification number issued previously will be valid only until the end of 2013.

In addition, the CRA is or will be reviewing all tax shelters. The CRA informs its auditors so they are kept up-to-date on tax avoidance strategies. The CRA is adapting the way it audits to include reviews of potential tax avoidance issues, and is consulting with the Department of Finance on legislative changes related to tax avoidance strategies.

A recent tax alert from the CRA advises that:

Mass marketed gifting tax shelter arrangements are made for the primary purpose of avoiding the payment of the required taxes rather than raise funds for charities. Mass marketed gifting tax shelters include schemes where taxpayers receive a charitable donation receipt with a higher value than what they paid. This can typically be four or five times their out of pocket cost. *The Canada Revenue Agency (CRA) audits every mass-marketed tax shelter arrangement and no arrangement has been found to comply with the Income Tax Act* (emphasis added).<sup>18</sup>

It is estimated that as of December 31, 2012, there had been approximately 204,000 participants in tax shelter donation schemes, with \$6.4 billion in donations reported. As of July 2013, the CRA had completed over 182,000

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<sup>18</sup> "Tax Shelters- Mass Marketed Tax Shelters", Canada Revenue Agency, accessed September 24, 2013, <http://www.cra-arc.gc.ca/gncv/1rt/vshlt-eng.html>.



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reassessments of taxpayers who had participated in tax shelter gifting arrangements, denying approximately \$5.9 billion in charitable donations.<sup>19</sup>

In addition to reviewing 100% of all tax shelters, the CRA must ensure that all registered charities are complying with their reporting obligations. As such, the CRA facilitates voluntary compliance of the charitable sector through a program of information and education, client services (telephone and written enquiries), and responsible enforcement of compliance through a graduated, education-first approach, where appropriate.

Audit results of registered charities for the 2011/2012 fiscal year were as follows<sup>20</sup>:

Results	Percentage - total of charities audited
Compliant (no issues found)	9%
Education	54%
Compliance Agreements	27%
Sanctions (Penalties)	0.4%
Revocations for cause	4%
All other (i.e., Annulments, Part V tax <sup>21</sup> )	5.6%

### **New legislation**

In 2002, the federal government introduced new legislation relevant to charities. The changes it proposed to the *Income Tax Act*, s. 248(35), specified that where a donation is made by way of a gift of property, the allowable charitable donation amount will be limited to the taxpayer's cost of the property if the property was acquired under a "gifting arrangement." Thus, if the item donated was acquired by the taxpayer for \$100, then \$100 will be the maximum allowable charitable donation amount. Bill C-48 received royal assent on June 26, 2013 and the legislation is retroactive to December 20, 2002.

*Bill C-38, An Act to Implement Certain Provisions of the Budget Tabled in Parliament on March 29, 2012 and Other Measures*, received royal assent

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<sup>19</sup> "2010 Fall Report of the Auditor General of Canada- Chapter 7- Registered Charities- Canada Revenue Agency", Office of the Auditor General, accessed September 24, 2013, [http://www.oag-bvg.gc.ca/internet/English/parl\\_oag\\_201010\\_07\\_e\\_34290.html](http://www.oag-bvg.gc.ca/internet/English/parl_oag_201010_07_e_34290.html).

<sup>20</sup> Statistics provided by the CRA in July 2012.

<sup>21</sup> Part V tax is sometimes referred to as revocation tax. Every revoked charity is subject to Part V tax, as defined in Section 188 of the ITA.

on June 29, 2012 and is now law. Bill C-13, *An Act to Implement Certain Provisions of the 2011 Budget as Updated on June 6, 2011 and Other Measures*, received royal assent on December 15, 2011. Among other things, Budget 2011 introduced measures to enhance transparency and improve accountability for registered charities and registered Canadian amateur athletic associations. It also extended certain regulatory requirements applicable to registered charities to other “qualified donees” that can issue official donation receipts.

Bill C-38 also imposed additional penalties for a tax shelter promoter who fails to either (1) file an annual information return when required by the CRA, or (2) report in an annual information return the amounts paid by a tax shelter participant or the name, address, and taxpayer identification number of the participant who acquires or otherwise invests in the tax shelter.

In the 2013 Budget<sup>22</sup>, the Government of Canada is proposing to extend the normal reassessment period of three years for tax shelters transaction in certain circumstances, for example, when the tax shelter or reportable transaction is not filed on time. The Budget also stipulated the following:

“The Canada Revenue Agency (CRA) is generally prohibited from taking collection action in respect of assessed income taxes and related interest and penalties where a taxpayer has objected to the assessment. The CRA has been successful in challenging charitable donation tax shelter cases in the Tax Court and the Federal Court of Appeal, but some taxpayers continue to participate in these questionable tax shelters. Prolonged litigation of these disputes can delay final collection of the taxes.

In order to discourage participation in questionable charitable donation tax shelters and to reduce the risk that unpaid amounts will ultimately become uncollectible, Budget 2013 proposes to modify the prohibition on the CRA from taking collection action in these cases. If a taxpayer has objected to an assessment of tax, interest or penalties that results from the disallowance of a deduction or tax credit claimed in respect of a tax shelter (as reported by the taxpayer or determined by the Minister of National Revenue) that involves a charitable donation, the CRA will be permitted, pending the ultimate determination of the taxpayer’s liability, to collect 50 per cent of the disputed tax, interest or penalties.”

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<sup>22</sup> “Annex 2: Tax Measures: Supplementary Information and Notices of Ways and Means Motions”, Budget 2013, accessed September 24, 2013, <http://www.budget.gc.ca/2013/doc/plan/anx2-eng.html>.

These provisions introduced in Budget 2013 were passed in Bill C-60, *Economic Action Plan 2013 Act, No. 1*, which received royal assent on June 26, 2013.

## CRA Requirement to Provide Information about Questionable Tax Schemes in a Timely Manner

The CRA's guide to the Taxpayer Bill of Rights (TBR) states at article 14 that:

*You can expect us (the CRA) to provide you with timely information about questionable tax schemes that are under scrutiny by the CRA. We can only warn you about tax schemes after we become aware of them and have determined that they may be questionable.*

More information about the TBR, as well as a link to the RC17, *Taxpayer Bill of Rights Guide: Understanding Your Rights as a Taxpayer*, can be found at [www.cra.gc.ca/rights](http://www.cra.gc.ca/rights).

In response to the complaints our Office has investigated, the CRA has stated that it cannot inform taxpayers of an audit of a tax scheme because the *Income Tax Act* prohibits the disclosure of private information about taxpayers. However, according to the *Taxpayer Bill of Rights*, taxpayers are entitled to be informed in a timely manner about questionable tax schemes that are under scrutiny by the CRA. Thus the CRA needs to find effective ways to warn taxpayers while respecting the confidentiality of taxpayer information.

Recently, as stated above, the CRA has implemented a new national policy whereby it will not process tax returns that include a credit related to a gifting tax shelter scheme unless the taxpayer chooses to remove the donation amount and wait for the outcome of the audit. If the taxpayer needs the assessment in order to receive benefits, for example, the Canada Child Tax Benefit, or social assistance, or for other financial reasons, such as for loans or mortgages, they will have the option of removing the donation claim, having their return processed and waiting for the outcome of the tax shelter audit. Should the tax shelter prove to be legal, taxpayers will be able to resubmit the claim for the donation and receive their refunds plus interest.

The CRA communicates information and general warnings on tax shelter donation schemes through various methods: on its website; in public notices; in brochures; in mail outs to taxpayers and third parties; and during trade shows for the public. In addition, the CRA issues numerous media releases, including articles, tax tips, tax alerts, news releases, tweets, and a video on



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YouTube on Giving to charity, which includes warnings about participation in tax schemes. We have reviewed the overall communication efforts to determine if the CRA provided sufficient warning to the public about the risks of participating in tax shelter donation schemes.

#### ***Delivering information and warnings on CRA's website***

The CRA posts a wealth of material regarding charities on its website, including information and warnings about tax shelters. In fact, the legislation requires that all registered charities include the name and website address of the CRA on their official donation receipts which provides taxpayers a constant reminder of where they can obtain further information on registered charities. Visitors to the CRA "Information for donors"<sup>23</sup> webpages have climbed from 49,000 in 2006 to 560,000 in 2011.

One way in which the CRA has issued information and warnings about tax shelter donation schemes is through posts on its webpage "Alerts."<sup>24</sup> These have included warnings that taxpayers should avoid all schemes that promise donation receipts for 3 to 4 times or more the cash payment, or reminders that tax shelter numbers are used for identification purposes only.

#### **Tax Alert**

**Warning: If you donate to a gifting tax shelter, expect to be audited**

#### **Tax Alert**

**Warning: Canada Revenue Agency has denied over \$2.5 billion in tax shelter gifting arrangement donations**

#### **Tax Alert**

**Warning: Schemes that promote big tax losses or deductions are not worth the risk**

<sup>23</sup> "Giving to charity: Information for donors", Canada Revenue Agency, accessed September 24, 2013

<http://www.cra-arc.gc.ca/chrts-gvng/dnrs/menu-eng.html>.

<sup>24</sup> "Alerts", Canada Revenue Agency, accessed March 7, 2014, <http://www.cra-arc.gc.ca/nwsrm/lrts/menu-eng.html>.



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Taxpayers can also subscribe to the CRA's electronic mailing list to receive news releases, fact sheets, tax tips and tax alerts as they are added to the website. Additionally, the CRA's website also has videos<sup>25</sup> on various subjects, including charitable donations.

If a taxpayer suspects that a tax shelter/charity is committing some sort of fraud, they can contact the CRA. The contact number is found on the "Information for donors" webpage:

"Report fraud to the Canadian Anti-Fraud Call Centre by calling 1-888-495-8501. You can also call the CRA's toll free numbers in Canada: 1-800-267-2384 (English) or 1-888-892-5667 (bilingual)."<sup>26</sup>

#### ***Other methods of delivering information***

As stated above, for those looking for it, the CRA publishes a multitude of communication products regarding charities and tax shelters on its website. However, as some complainants reported to us, not everyone suspects that their payment is being made under an abusive tax scheme, thinks to consult the CRA website for information, or has access to a computer. So, in addition to the information published on its website, from 2009 to 2011 the CRA advertised across the country in numerous national and community newspapers; magazines, some of which targeted a senior audience; radio stations; and websites. A total of 171 stories were published over those three years, with an estimated reach of 17,862,366 Canadians.

As well, the CRA published public notices in 2006, 2007 and 2009 that contained specific warning about gifting tax shelter donation schemes. The notices were published in over 75 newspapers across Canada for an estimated total reach of 10 million each year.

The CRA's information campaign is also available on the Internet, on radio stations and in various print media. The CRA has provided our Office with a list of advertisements that appeared in different websites, radio stations, newspapers and magazines with the "reach" of the population for each.

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<sup>25</sup> "Videos and recorded webinars for donors and charities", Canada Revenue Agency, accessed September 24, 2013, <http://www.cra-arc.gc.ca/vdgllry/chrtsgvng/menu-eng.html>.

<sup>26</sup> "CRA- Donations and Donors- Questions and answers", Canada Revenue Agency, accessed September 24, 2013, <http://www.cra-arc.gc.ca/chrtsgvng/dnrs/fa-eng.html#q15>.



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A press release<sup>27</sup> issued by the CRA on October 30, 2012, advised taxpayers that the CRA is developing innovative ways to deter participation in charitable tax schemes:

“Starting with the 2012 tax year, the CRA will put on hold the assessment of returns for individuals where a taxpayer is claiming a credit by participating in a gifting tax shelter scheme. This will avoid the issuance of invalid refunds and discourage participation in these abusive schemes. Assessments and refunds will not proceed until the completion of the audit of the tax shelter, which may take up to two years. All gifting tax shelter schemes are audited and the CRA has not found any that comply with Canadian tax laws. A taxpayer whose return is on hold will be able to have their return assessed if they remove the claim for the gifting tax shelter receipt in question.”

The CRA mailed information cards to 900,000 households in 2007 and 2008 that contained warnings about tax shelter donation schemes and where to find additional information. The target audience in 2007 was taxpayers who had claimed charitable donations of \$100 or more on their 2006 tax returns and who were between the ages of 45 and 75.

The 2008 mail out targeted taxpayers who had claimed charitable donations of \$200 or more on their 2007 tax returns, and who were between the ages of 30 and 75.

In 2010, an additional 600,000 information cards were issued to recent post-secondary graduates who earned more than \$32,000. The cards were designed to raise awareness of registered charities among recipients and encourage them to visit the donor webpages in order to view the new videocasts.

In 2006, the CRA began participating in trade shows and fairs across Canada to encourage taxpayers to donate wisely and to avoid gifting tax shelters. The program has attended 58 events and greeted more than 100,000 visitors.

The CRA has issued 40 News Releases and Tax Alerts since 2006. As a result, the CRA has created a steady stream of media attention on this issue.

Information has not been restricted to potential donors. For a tax shelter scheme to exist, it needs the participation of a charity because of the charity’s donation receipting privileges. In reaching out to the charitable organizations and warning them before they become involved in a tax

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<sup>27</sup> “The Canada Revenue Agency: protecting Canadians from gifting tax shelter schemes”, Canada Revenue Agency, accessed September 24, 2013, <http://www.cra-arc.gc.ca/nwsrm/riss/2012/m10/nr121030-eng.html>.



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shelter, the CRA is hoping that it will reduce charities' participation in tax shelter schemes.

The CRA mailed letters in 2007 to leading charitable organizations warning charities and fundraising professionals to avoid tax shelter arrangements. Information letters were also sent directly to vulnerable organizations warning against participation. The letters included examples of prominent schemes and advised the sector about the repercussions of participating in those schemes, such as revocation of charitable status and monetary penalties.

The CRA also posts revocations<sup>28</sup> of charitable organizations on its website and in the *Canada Gazette* as they happen. The announcement explains the reasons of the revocation and states that "the charitable organization will no longer be able to issue donation tax receipts for income tax purposes and is no longer a qualified donee under the *Income Tax Act*."

## Information Available Through Third Parties

The CRA is not the only source for information and warnings. Valuable information regarding tax shelter donation schemes has also been released by other parties.

A number of reports have been issued in the media, such as the *Globe and Mail*<sup>29</sup>, the *Financial Post*<sup>30</sup>, and the *Toronto Star*<sup>31</sup>. David Baines of the *Vancouver Sun* published an article on October 22, 2012, regarding the VIA Project. In this article, Mr. Baines wrote that he had warned readers about a tax deduction scheme called the VIA Project in November 2011 and that the CRA was now proposing to disallow all donations claimed by taxpayers from the VIA Project for the year 2010.

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<sup>28</sup> CRA website, Charities and giving, accessed November 25, 2013: <http://www.cra-arc.gc.ca/chrts-gvng/menu-eng.html>

<sup>29</sup> "Agency shuts down two charities in alleged scheme", *Globe and Mail*, August 11, 2009, <http://www.theglobeandmail.com/news/national/agency-shuts-down-two-charities-in-alleged-scheme/article4213771/>.

<sup>30</sup> "Tax Expert: Donation tax schemes take series of blows", *Financial Post*, June 6, 2010, <http://www.financialpost.com/related/topics/Expert+Donation+schemes+take+series+blows/3107760/story.html>.

<sup>31</sup> "CRA targets David Singh's charitable tax shelters", *Toronto Star*, April 19, 2010, [http://www.thestar.com/news/canada/2010/04/19/cra\\_targets\\_david\\_singhs\\_charitable\\_tax\\_shelters.html](http://www.thestar.com/news/canada/2010/04/19/cra_targets_david_singhs_charitable_tax_shelters.html).



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Other charitable sector websites such as Canadian Charity Law<sup>32</sup> and Global Philanthropy<sup>33</sup> have posted warnings. The Smart Giving website<sup>34</sup> also offers information about tax shelter donation schemes. Likewise, it offers tips to consider when donating to a Canadian registered charity.

The Canadian Cultural Property Export Review Board (CCPERB) is an independent tribunal of the Department of Canadian Heritage which was established in 1977 by section 18 of the *Cultural Property Export and Import*

The Canadian Cultural Property Export Review Board (CCPERB) is an independent tribunal of the Department of Canadian Heritage that certifies cultural property for income tax purposes.

Act. Among its various responsibilities, the Board certifies cultural property for income tax purposes. In this role, it makes decisions about the “outstanding significance and national importance” and the fair market value of objects or collections donated or sold to designated Canadian museums, art galleries, archives and libraries.

Some tax shelter donation schemes involve the donation of art or vintage photographs. The CCPERB has posted a warning on its website about tax shelter gifting arrangements, warning “designated institutions and public authorities, artists, donors and monetary appraisers [to] exercise caution when presented with proposals to participate in tax shelter gifting arrangements for cultural property.”<sup>35</sup> It also stated that in the future, all applicants for certification would be required to provide a tax shelter number if the property was part of a tax shelter gifting arrangement.

In an effort to raise awareness, the Office of the Taxpayers’ Ombudsman has put a warning on its website and in its *Perspectives* Newsletter.<sup>36</sup>

## Tax Shelter Schemes in Other Jurisdictions

Other tax agencies around the world are also dealing with tax shelter donation schemes. Some countries estimate that the abuse of charities costs their treasury many hundreds of millions of dollars and have found that this

<sup>32</sup> Canadian Charity Law accessed September 24, 2013, <http://www.canadiancharitylaw.ca/>.

<sup>33</sup> Global Philanthropy accessed September 24, 2013, <http://www.globalphilanthropy.ca/>.

<sup>34</sup> “Common Charity Scams”, Charity Law Information Program, accessed September 24, 2013, <http://www.smartgiving.ca/charity-scams/common-charity-scams>.

<sup>35</sup> “Advisory on Tax Shelter Gifting Arrangements”, Canadian Cultural Property Export Review Board, accessed September 24, 2013, <http://www.pch.gc.ca/eng/1347044424978/1347045197980>.

<sup>36</sup> “Tips for Taxpayers- Charitable Tax Schemes”, *Perspectives*; Issue 2, October 2012, Office of the Taxpayers’ Ombudsman, <http://www.oto-boc.gc.ca/rpts/bltn-rpts-eng.html>.



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type of abuse is becoming more prevalent. These tax agencies provide information and warnings to taxpayers as well.

The Australian Taxation Office<sup>37</sup> provides information on its website regarding arrangements that promote tax deductions for gifts of pharmaceuticals for use overseas. It warns taxpayers that the arrangement was found to be a tax avoidance scheme and participants in the scheme have their tax deductions disallowed.

The Internal Revenue Service<sup>38</sup> website includes a page of “Tax Fraud Alerts,” where a number of alerts have been issued describing what tax schemes, or tax scams, look like and the consequences of participation. Additionally, it provides information on how individuals can report a suspected abusive tax shelter.

In its 2011 Budget, the Province of Alberta warned Albertans not to fall victim to illegal charitable donation “programs” or “tax planning arrangements”, which are marketed as a means for donors to get more back as a tax refund than the amount they initially give.<sup>39</sup> The Province warned that these programs contravene federal and provincial income tax legislation and that participants should be aware that the CRA will disallow the charitable donations credit and require individuals to pay unpaid taxes, interest, and penalties. This is in addition to the loss of the original donation. They state that in the end, participants are worse off than if they had avoided the scheme altogether.

Likewise, Revenu Québec advises taxpayers that gifting tax shelters should be avoided. It states that: “In the documentation that promoters provide, they often claim to have obtained a legal opinion or fiscal advice from a law firm. Oftentimes, such opinions or advice consists of general comments and do not fully support the activity in question.”<sup>40</sup>

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<sup>37</sup> “Charity Donation Schemes”, Australian Taxation Office, accessed September 24, 2013, <http://www.ato.gov.au/General/Tax-planning/In-detail/Compliance-updates/Charity-donation-schemes/>.

<sup>38</sup> “Tax Fraud Alerts”, Internal Revenue Service, accessed September 24, 2013, <http://www.irs.gov/uac/Tax-Fraud-Alerts>.

<sup>39</sup> “Buyer Beware: Charitable Donations Schemes”, Alberta Budget 2011-Tax Plan, accessed September 24, 2013, <http://www.finance.alberta.ca/publications/budget/budget2011/tax-plan.pdf>.

<sup>40</sup> “Charitable Donations, Tax Shelters and Fraudulent Practices” Revenu Québec, accessed September 24, 2013, <http://www.revenuquebec.ca/en/salle-de-presse/nouvelles-fiscales/2012/2012-03-27.aspx>.

## Conclusion

The CRA has been warning taxpayers of the consequences of participating in tax shelter donation schemes for more than ten years. There is a substantial amount of information on the CRA's website and the CRA has published information in a variety of newspapers, magazines, and various other media sources, information that includes warnings about tax shelters and donating wisely. Yet people continue to be persuaded to participate in tax shelter donation schemes.

Individuals should always use caution and not fall prey to pressure-selling tactics by personable promoters. The media and other sources have abundantly commented on tax schemes. "You cannot make a 'donation' or investment of \$2,500 and get a tax receipt for \$10,000...The phrase 'If it sounds too good to be true it probably is' should be 'if it sounds too good to be true in the charity donation tax shelter area then it definitely is.'"<sup>41</sup> Furthermore, taxpayers should not expect to profit from a charitable donation. They should not expect to receive receipts and an income tax refunds for more than their actual donation.

The line between what is acceptable tax planning and what is abusive often lies in grey areas.

Before issuing a tax shelter identification number, the CRA reviews the information provided by a tax shelter to ensure that all prescribed information is submitted. However, the CRA must issue an identification number once all required information has been provided. The CRA cannot take action until the program is promoted and sold to participants. The Auditor General of Canada reviewed this issue and confirmed that the CRA was acting according to the legislation.<sup>42</sup>

The CRA's website states clearly that a tax shelter identification number does not automatically entitle the participants to tax benefits. In addition, all tax shelters are required to include in their material a disclaimer that refers to the identification number as follows:

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<sup>41</sup> "Toronto Star article 'CRA targets David Singh's charitable tax shelters'", Canadian Charity Law, accessed September 24, 2013, [http://www.canadiancharitylaw.ca/index.php/blog/comments/toronto\\_star\\_article\\_cra\\_targets\\_david\\_singhs\\_charitable\\_tax\\_shelters/](http://www.canadiancharitylaw.ca/index.php/blog/comments/toronto_star_article_cra_targets_david_singhs_charitable_tax_shelters/).

<sup>42</sup> "2010 Fall Report of the Auditor General of Canada- Chapter 7- Registered Charities- Canada Revenue Agency", Office of the Auditor General, accessed September 24, 2013, [http://www.oag-bvg.gc.ca/internet/English/parl\\_oag\\_201010\\_07\\_e\\_34290.html](http://www.oag-bvg.gc.ca/internet/English/parl_oag_201010_07_e_34290.html).



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“The identification number issued for this tax shelter shall be included in any income tax return filed by the investor. Issuance of the identification number is for administrative purposes only and does not in any way confirm the entitlement of an investor to claim any tax benefits associated with the tax shelter.”<sup>43</sup>

The CRA continues to focus on promoters who create schemes and undertakes criminal investigations when the circumstances warrant. When required, the CRA may also call upon the assistance of law enforcement agencies during the course of an investigation. The CRA Criminal Investigations Program is responsible for investigating the most egregious cases of tax evasion and focusses its efforts on promoters of such schemes. The CRA will, when sufficient evidence exists to prove tax evasion, recommend for criminal prosecution those promoters of tax shelter schemes who deliberately and willfully choose to evade the law. Since June 2000, the CRA has also assessed \$136.9 million in third-party penalties against promoters and tax preparers who advised their clients to participate in a tax shelter donation scheme.<sup>44</sup>

Many more changes are helping the CRA confront this issue. As Bill C-38 is implemented, new requirements regarding tax shelter numbers and reporting will lead to an increase in the penalty for promoters of these types of tax shelters where they file false or misleading information in the tax shelter application or sell an interest in the tax shelter before the Minister has issued a tax shelter identification number. Also a new penalty has been introduced for a promoter who fails to meet its reporting obligations in its annual information return. To help the CRA determine whether a tax shelter remains active, a tax shelter number will be valid for only a year instead of indefinitely.

Some tax scheme participants feel that because the CRA did not question their donations in past income tax returns, or because they have been shown the assessments of someone else who has received a refund following their claim for the donation, the CRA accepted their donations. However, donors often confuse “accepted as filed” with “reviewed and approved.” The CRA cannot review every one of the more than 25 million returns filed each year and usually assesses them “as filed.” This does not mean that the CRA has allowed all that was reported on the tax return. Canada has a self-assessment taxation system and the onus rests with each taxpayer to

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<sup>43</sup> “A tax shelter identification number does not automatically entitle the participants to tax benefits”, Canada Revenue Agency- Tax Shelters, accessed September 24, 2013, <http://www.cra-arc.gc.ca/gncv/rt/vshlt-eng.html>.

<sup>44</sup> “The Canada Revenue Agency: protecting Canadians from gifting tax shelter schemes”, Canada Revenue Agency, October 30, 2012; accessed September 24, 2013, <http://www.cra-arc.gc.ca/nwsrm/riss/2012/m10/nr121030-eng.html>.



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prepare complete and accurate tax returns. The CRA will review tax returns randomly, because of various risk factors, or as part of a project to suppress tax avoidance. For example, if there is a claim for a credit on the tax return for charitable donations, it might get selected for review.

Again, donors should note that to date, no gifting tax shelters have been found to be compliant with the legislation. Not one. Thousands of reassessments have been completed, removing these claims from donors' income tax returns, resulting in millions of dollars being owed to the government. With the amounts owing plus penalties and interest, donors who were expecting to receive a large refund are left worse off than when they started. As for the money that participants gave to a promoter of the tax shelter donation scheme, there is very little hope that they will ever recuperate that money.

In order to avoid issuing these inflated tax refunds which later need to be recovered, starting with tax year 2012, the CRA has nationally stopped issuing assessments of returns to individuals who claim a credit for a gifting tax shelter scheme. Donors will be able to receive their notice of assessment only if they remove their claim for the donation. Otherwise, their assessment will be delayed until the audit of the tax shelter is completed. Additionally, in an effort to discourage participation in donation tax shelters, the CRA will be permitted to collect up to 50% of the taxes in dispute, interest and any applicable penalties which result from the disallowance of a donation claimed with respect to a tax shelter, even before completion of the appeal process.

During the course of this investigation, it became apparent that more needs to be done by the CRA to warn Canadians about tax shelter donation schemes and their promoters.

While some people are no doubt motivated by greed and willingly take the risk of investing in dubious tax shelter donation schemes, we have heard from donors who claim to have been duped into participating in what they thought was a legitimate charity.

The promoters can be very persuasive, using convincing evidence such as the CRA's list of registered charities (since the tax shelter needs the participation of a registered charity for its receipting privileges in order to exist); Notices of Assessment and tax refund cheques issued by the CRA to participants in the scheme; and legal opinions from reputable law firms, to make the point that such contributions are within the law. In reality, this "evidence" is deliberately misleading and provided without context. For example, the CRA Notice of Assessment reflects the income tax declaration as filed before an audit, not the final assessment.



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We recognize that the CRA has made many efforts to educate and inform Canadians about the risks involved with investing in tax shelter donation schemes. We believe, however, that more could and should be done to alert the public to the specific types of schemes being promoted in Canada that are non-compliant with the *Income Tax Act* and how to recognize them. We also believe that much could be done to enhance the CRA's communication efforts on this subject, in ways that are cost effective, by having others help spread the message.

For example, Members of Parliament could include warnings about tax schemes in the "householder" newsletters they distribute to their constituents, at no cost to the CRA. Since the complaints we have received suggest that many seniors are getting caught up in tax schemes, the CRA should enlist the help of associations representing seniors and retired people in distributing warnings to their membership. Likewise, print and electronic publications serving specific cultures, groups, and communities could be helpful in alerting their audiences to the risks and consequences of donating to tax schemes. These are just some of the ways in which the CRA could seek to alert more people to the perils of investing in schemes that will ultimately cost them money rather than save or make them money.

The CRA is taking steps to reduce the impact on taxpayers as well as protect the tax base by holding the assessments in abeyance pending an audit of the tax shelter. In addition, the CRA has released information and warnings to taxpayers through various channels, such as media, Internet, and printed publications. Organizations nationally and internationally are warning taxpayers of the consequences of getting involved in tax shelter schemes. And based on the decrease in participants, it is fair to say that the majority of potential donors are getting the message.

Since 2006, the CRA has seen a decrease of 82% in the number of participants in tax shelter donation schemes, from 50,000 participants per year to 8,400 participants per year, and a decrease of 77% in the amount of disallowed donations.

However, there are still people who continue to participate in tax shelter donation schemes. While the CRA is working towards protecting the tax base and reducing the impact on taxpayers, the fact is Canadians are still giving money to these tax shelters and attempting to claim the donation on their return. Regardless of whether or not the return is assessed, the taxpayer has lost money that may have otherwise gone to support the charitable sector. The CRA needs to continue its efforts to inform taxpayers about the dangers of investing in a charity-related tax shelter, as well as analyze the trends in tax shelter contributions in order to develop and target appropriate communication products.



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## Recommendations

Based on the foregoing, the Taxpayers' Ombudsman recommends that the CRA:

1. Continue to develop and apply innovative and effective communication strategies to warn taxpayers about the potential consequences of participating in tax shelter donation schemes, including a determination of key audiences and distribution targets.
2. Develop effective communication products that provide clear examples of tax schemes that do not conform to the *Income Tax Act* as well as warn of the potential consequences of participating in tax shelter donation schemes and distribute as effectively as possible.
3. Warn taxpayers about questionable tax schemes in a timely manner by monitoring trends in the structuring of, and investing in, tax schemes and make such information publicly available as soon as possible.
4. Explore ways of preventing promoters of questionable tax schemes from using information from the CRA to promote their products and provide clear warnings to the public that by issuing a “tax shelter identification number” the CRA is not approving a tax shelter or confirming that it conforms to the *Income Tax Act*.