Dangerous Opinions –

Legal and Ethical Issues with Legal Opinions on Charity Law and the *Income Tax Act*

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Introduction

Charitable and not-for-profit organizations provide critical social, community and family services all over Canada. They enhance quality of life through various pursuits including sport and recreation, arts and culture, health, education, environment and philanthropy.

Charitable and not-for-profit organizations represent a significant part of our economy generating approximately $90 billion annually, employing more than 1.5 million Canadians and mobilizing more than 12.5 million volunteers.

While charitable and not-for-profit organizations raise revenue in a variety of ways, donations represent a crucial component of the resources required in order for these organizations to do their work.

Charitable giving receives favourable tax treatment in order to incentivize individuals to be charitable and to “reward” and support those who give.

Favourable tax treatment is often a key motivator in charitable giving.

For many years, Canadians have participated in various gifting arrangements that resulted in donation receipts which had a value greater than the actual amounts donated by the individual. The Canada Revenue Agency (“CRA”) has warned and continues to warn Canadians against these gifting arrangements and audits those who participate.

Charitable Gifting Arrangements

Charitable gifting arrangements became extremely popular in Canada in the late 1990’s and were promoted aggressively attracting tens of thousands of participants across the country up until very recently.

In the past few years, the popularity of these programs seems to have waned as CRA began auditing all individuals who made donation claims through gifting arrangements. CRA also began revoking the charitable status of organizations that developed and promoted the gifting arrangements.

As of early 2010, CRA had denied over $4.5 billion in charitable gifting arrangement donations and reassessed over 130,000 taxpayers who made donation claims through such arrangements.

Charitable gifting arrangements are big business. Packages from promoters often reference a legal or tax opinion which is said to support the validity of the arrangement and the validity of the charitable donation tax receipt to be issued.

There were and are various forms of gifting arrangements promoted. The one element that all have in common is that participants receive/received a charitable donation tax receipt which has a value significantly greater than the actual amount donated (cash out-of-pocket) by the participant.

Some of these gifting arrangements include the following:

1. Global Learning Gifting Initiative/Millennium Charitable Foundation
2. Berkshire Funding Initiatives Ltd.
3. Canadian Humanitarian Trust
4. Funds for Canada Foundation/Parklane Financial Group Limited
5. Banyan Tree Foundation Gift Program

1. Global Learning Gifting Initiative/Millennium Charitable Foundation

Millennium Charitable Foundation ("Millennium") was a qualified donee under the *Income Tax Act* (the "*Act*") and was a registered charity under the *Act*.

In 2004, Global Learning Trust (2004) ("Global Trust") was created by a resident of the Bahamas.

International Charity Association Network (ICAN) was the income beneficiary of the trust. ICAN was a qualified donee and a registered charity under the *Act.* .

Infosource Inc., a Florida corporation, was in the business of designing, creating, marketing and selling to the public various computer software programs (the "courseware") which provide training solutions for those interested in learning about personal computer software applications and obtaining advanced technical and business skills.

Global Trust owned a number of transferable, royalty free, perpetual licenses of the courseware.

It appears that the Global Learning Gifting Initiative ("GLGI") charitable donation program operated in the following fashion:

- donors/participants made a cash payment to Millennium;
- donors also made an application to become a capital beneficiary of Global Trust;
- Global Trust had the absolute discretion to accept or reject an application;
- if accepted as a capital beneficiary, the donor/participants received a capital distribution from the trustee of Global Trust in the form of courseware which would then be donated to ICAN;
- donors/participants received a donation receipt from Millennium for the amount of the cash payment and a donation receipt from ICAN for the courseware;
- the fair market value attributed to the courseware on the donation receipt from ICAN was roughly 3-5 times the amount of the cash payment made to Millennium;
- the combined tax credit available from the 2 donation receipts was always more than the actual cash payment and resulted in a positive return to the donor/participant of 56%-89% depending on the province of residence and the tax rates in effect.

The promotional material for the program emphasized the tax advantages of the program. Transactions were pre-arranged and directed entirely by the promoter, Global Learning Group Inc., and another Canadian corporation.

The promotional material referenced a legal opinion provided by a national law firm and also referenced a tax opinion provided by an accounting firm.

The legal opinion, provided in August, 2002, concludes that courseware acquired by an individual and subsequently donated to a registered charity will entitle the individual to a tax credit equal to the maximum combined federal and provincial tax rates based on the fair market value of the courseware.

In November, 2004, a different national law firm provided a 62-page legal opinion in connection with the same program.

The second legal opinion, consistent with the first, essentially concludes that participants would be entitled to claim a tax credit for donation of courseware to a registered charity based on the fair market value of the courseware. It also concludes that the General Anti-Avoidance Rule ("GAAR") should not apply to the transactions.

The stated limitations on the opinion include the following:

> Our opinion is being provided to Global Learning Group Inc. ("GLGI") solely for its own use in connection with structuring the Program and for no other purpose whatsoever. Our opinion may not be provided to any other person or otherwise circulated and, should any other person receive a copy of our opinion, they are not entitled to rely on it.
>
> There can be no assurance that Canada Revenue Agency ("CRA") will agree with any or all of the opinions set forth herein. CRA has not been requested to provide an Income Tax Ruling on the Federal income tax consequences of the Program.

Our opinion is based solely on the following facts which have been provided to us by GLGI. We have not independently verified the accuracy of any of these facts. Any change to these facts could have a material adverse effect upon our opinion herein…

Our opinion is based exclusively on the facts and assumptions set forth herein and the Law as of the date hereof. It is assumed that all proposed amendments to the Law will be enacted into law in the form currently publicly proposed. It is also assumed that all information provided to us by any court office or other governmental authority is accurate.

This opinion may be relied upon only by GLGI in connection with structuring the Program and not by any other person nor for any other purpose. This opinion is being provided to be used to solicit participation in the Program. This opinion may not be quoted from nor its contents nor the fact of its existence otherwise referred to without our prior written consent. This opinion may not be provided to any other person or otherwise circulated and, should any other person receive a copy of our opinion, they are not entitled to rely on it.

The benefit of this opinion may not be assigned in whole or in part to any person either by contract or by operation of Law.

We have assumed without any due diligence or independent verification on our part that all facts and assumptions set forth herein regarding the proposed transactions and the parties thereto are accurate. We note that these facts and assumptions are critically important to the opinions expressed herein.

There can be no guarantee that CRA or the courts in applying the Law to the proposed transactions set forth herein might not reach different conclusions then those set forth in our opinion. No advance tax ruling has been sought or obtained

> from CRA to confirm the tax consequences of any of the transactions described herein.
>
> We undertake no responsibility to advise of any changes to the Law or in any facts or assumptions herein set forth which changes may come to our attention after the date hereof and which may affect any of our opinions herein.
>
> No opinion is being provided and none shall be inferred save and except with respect to those matters herein set forth.
>
> All statutory references herein are to the ITA unless otherwise indicated. All terms not defined herein shall have the same meaning as under the ITA.
>
> No claim may be made by GLGI for breach of contract, in negligence or otherwise against [law firm] in connection with any loss or damages suffered by GLGI arising out of, in relation to or connected with, any reassessment by CRA of any Donor or any other person who may make a claim against GLGI arising out of or in connection with the transactions herein.

CRA denied the full charitable donation tax credits claimed by participants with respect to the GLGI charitable donation program.

The CRA disallowance letters state that there was a lack of donative intent on the part of donors/participants. The primary motivation of donors was not to enrich charities and assist in fundraising, but to make a profit from the tax credits obtained.

CRA took the position that donors made cash payments with the expectation that they would receive charitable donation receipts that would allow them to claim tax credits greater than the cash payments. The series of transactions were pre-arranged with the result that, for cash payments made donors/participants would claim a donation credit approximately 4 times greater than the cost of participating in the program (actual cash outlay).

It is CRA's position that all donors/participants participated in the program with full knowledge of this material benefit.

CRA concluded that there was no donative intent because there was no element of impoverishment. CRA says the transactions cannot be characterized as gifts.

CRA further concluded that all donors/participants received consideration for the "cash donation" portions in the form of a benefit or advantage linked to and flowing from pre-arranged conditions.

CRA concluded that even the cash payment to Millennium was not a free and clear transfer to Millennium. It found that Millennium did not have unfettered use of the cash and did not benefit from the payments.

CRA found that Millennium had entered into an agreement with Global Learning Group Inc. to pay that company "fundraising fees".

CRA says that ICAN was required to remit almost all funds received from Millennium to Global Learning Group Inc. As a result, 90% of the cash payments made by donors in the program ended up in the hands of the promoter, Global Learning Group Inc. Neither charity, Millennium or ICAN, ever had control over the use of the cash payments received.

CRA says there cannot be a complete gift if the donee does not have control over the property. It therefore follows that there was no gift and the cash payment made to Millennium was not a gift at all. It was rather an indirect payment to the Global Learning Group Inc. as promoter as a fee to participate in the program.

CRA furthermore concluded that the donors never owned the courseware and could not transfer that property to ICAN. The transactions were therefore not legally effective.

CRA furthermore concluded that Global Trust is not a valid trust concerning the courseware.

As a secondary position, CRA maintained that the fair market value recorded on donation receipts for the courseware is inflated. CRA is of the view that the true fair market value is nominal.

CRA revoked the charitable registration of Millennium on January 10, 2009, stating that:

> Our audit has concluded that from January 1, 2003 to December 31, 2006 The Millennium Charitable Foundation issued in excess of $169 million in receipts for cash and property received through tax shelter arrangements. The Charity, in turn, directed $114 million of the cash and property to two other registered charities also participating in these arrangements. The audit revealed that the vast majority of the cash sent to the other participant charities was subsequently paid to the promoters. Of the remainder, the Charity itself paid $33 million in fundraising fees to the tax shelter promoters and retained, but did not disburse, $21 million in net assets. In fact, it appears that beyond these transfers (i.e., those that the Charity is directed to make by the tax shelter promoters), the Charity has only made a single $2,200 gift to another qualified donee.
>
> It is our position that the Charity has operated for the non-charitable purpose of promoting a tax shelter arrangement and for the private benefit of the tax shelter promoters. The Charity has issued receipts for transactions that do not qualify as gifts, issued receipts otherwise than in accordance with the *Income Tax Act* and its Regulations, has failed to maintain sufficient books and records to support its activities and has used its income for the personal benefit of its trustees. For all of these reasons, and for each of these reasons alone, it is the position of the CRA that the Charity's registration should be revoked.

CRA apparently denied the full charitable donation tax credits with respect to participation in the GLGI donation program.

2. Berkshire Funding Initiatives Ltd.

Berkshire Foundation Limited was incorporated on September 5, 2000. It was renamed Talisker Funding Limited six months later ("Talisker").

Berkshire Funding Initiatives Limited was incorporated on September 18, 2000 ("Berkshire").

Ideas Canada Foundation ("Ideas") is a registered public foundation and is set-up as a Canadian registered charity by the principal shareholders and directors of Talisker.

Ideas was purportedly created to fund various arts and cultural events in Ontario. One such event involved the purchase of twelve bronze statues by the Canadian Art Gallery for $108,000,000.00 U.S.

The purported charitable donations and the purchase of the bronze statues by the Canadian Art Gallery was facilitated through loans paid off in one day.

A non-resident art dealer who was involved in the sale of the twelve bronze statues controlled two off-shore companies that were incorporated in the United States and in the United Kingdom.

Berkshire was retained by Ideas as a fund-raising agent.

All of the donations made to Berkshire were directed to the Canadian Art Gallery (a registered charity). In turn, the Canadian Art Gallery was to direct the charitable funds to the U.K. Corporation to purchase the art. This occurred on December 1, 2000. It was later found out that the artwork was sold by the U.K. agent to the Canadian Art Gallery for $108,840,000.00 U.S. Just prior to this purchase, on the same day, the non-resident art dealer purchased the statues from its U.S. Corporation for $6,000,000.00 U.S. One day prior to that, the U.S. Corporation had purchased the art from the manufacturer on November 30, 2000 for $6,000,000.00 U.S.

The amount of the sale price to the art gallery less commission paid to the agents was directed to the non-resident art dealer who then directed the amount that was needed to finance a loan to Talisker's non-resident lender. The non-resident lender, in turn, directed this amount back to Talisker for the loan. This allowed Talisker to provide the donors with a loan. Talisker transferred the donor's promissory note as a security deposit to the non-resident art dealer in full satisfaction of the debt to the non-resident lender.

All of the transactions were pre-determined and were facilitated by a bank. All of the directions were prepared in advance by a large, well-known law firm.

The CRA subsequently held that the fair market value of the art was only $6,000,000.00 and that the grossly inflated price was in order to facilitate the funds to provide 25-year interest-free financing.

It is also worth noting that following the circular transfer of the funds, the twelve bronze statues were not in fact transferred to the Canadian Art Gallery.

To facilitate the donation program, Berkshire prepared an information package regarding the donation scheme and information for Ideas.

The promotional material specifically referenced a tax opinion in support of the program:

> A tax opinion has been obtained from the Law Firm of XXXX with respect to the tax implications of an individual donating cash to registered charities, a portion of which is funded by an interest free loan to the donor. XXXX is Canada's largest law firm dealing exclusively in the area of taxation. A second confirming tax opinion has been given by YYYY regarding Quebec Provincial Tax implications for residents of Quebec. The tax opinions may be reviewed upon request and after signing the confidentiality agreement. Individuals are urged to consult their own advisors about tax implications when making a donation.

The tax opinion indicates:

> The opinions expressed in this letter may be relied upon only by the person to whom it is addressed (the "addressee") and by a Donor who is provided a copy of this letter by the addressee or its agent, and by no other person.

The legal opinion reviews the jurisprudence regarding the definition of a "gift" and held that the proposed donation plan does satisfy the definition of a gift under the *Act*.

The opinion concluded that CRA should not be able to successfully apply GAAR to deny a tax credit otherwise available to a donor through participation in the Berkshire program.

It has been reported to us that approximately 1,040 individuals participated in this program with a portfolio of almost $700 million.

CRA apparently denied the full charitable donation tax credits with respect to participation in the Berkshire program.

It was CRA's position that the financed portion of the donation was not a valid gift for the purposes of Section 118.1 of the *Act*.

CRA took the position that there was no valid gift, the 25-year interest-free loan was a sham and that GAAR applied.

3. Canadian Humanitarian Trust

The Canadian Humanitarian Trust Donation Program ("CHT Donation Program") was stated to be a structured charitable donation program designed to increase the value of Canadian taxpayers' charitable donations. The stated goal of the program was to provide Humanitarian

assistance on a global scale by enabling the distribution of world health organization medicines to treat those in need around the world.

Participants in the program made a cash donation and received a charitable donation receipt for the cash. Participants applied to become a capital beneficiary of a Trust and received a capital distribution from the Trust in the form of pharmaceuticals purchased by the Trust in a foreign market at a significant discount.

The fair market value of the pharmaceutical units received is far more than the actual cost. This was explained apparently because the pharmaceuticals are purchased in a foreign market where they were available at a significant discount, and also because they were acquired based on a volume discount.

Participants in the program then donated the pharmaceuticals to a registered charity at a value amount far exceeding the amount of the actual cash paid.

Participants in the program received two charitable tax receipts: one for their cash donation and the other for the net fair-market value of the pharmaceutical units.

The promotional material for the CHT Donation Program referenced the Canadian law firm of XXX of Toronto and specifically XXX, Q.C. …

The promotional material indicates that an Ontario resident who made a cash donation of $12,390.00 would receive charitable tax receipts totaling $41,790.00 resulting in tax credits of $19,391.00 and a net position of approximately 57% in access of the cash donation amount.

Interestingly, the promotional material also indicated that a “Legal Defence Fund” in the amount of $500,000.00 had been established to defend any reassessment or other action related to the CHT Donation Program.

It seems obvious that the promoters anticipated that the validity of the program may be challenged.

CRA audited all individuals who participated in the CHT Donation Program and who made claims for charitable donation tax credits. CRA determined that no amount is allowable as a charitable gift.

CRA concluded that the cash donations associated with the CHT Donation Program were distributed as follows:

- approximately 5% used as fees by the charities to the promoter of the Program;
- approximately 33% paid to the Corporation that promoted the CHT Donation program;
- approximately 52% was wire transferred to a Corporate bank account in Cypress;
- Canadian charities received approximately 3%

CRA concluded lack of donative intent with respect to participation in the program, no valid gift, inflated fair-market value of the pharmaceutical units, etc.

Internet reports indicate that approximately 25,000 Canadians participated in the CHT Donation Program.

4. Funds for Canada Foundation/Parklane Financial Group Limited

The “Donations Canada” Charitable Donation Program is said to have received approximately $100 million in donations between 2004 and 2009.

Funds for Canada Foundation (“Funds for Canada”) was a registered Canadian charity.

Donations Canada Financial Trust was a private Canadian charitable trust.

Parklane Financial Group Limited ("Parklane") and Trafalgar Associates Limited ("Trafalgar Associates"), were Ontario corporations that allegedly marketed, administered and sold the program.

Trafalgar Trading Limited ("Trafalgar Limited"), was a Bermuda corporation that allegedly marketed, administered and sold the program.

Trafalgar Securities Limited and Trafalgar Research (Bermuda) Limited, were Bermuda corporations that allegedly marketed, administered and sold the program.

TCL Trafalgar, B.V., was a Netherlands corporation that allegedly marketed, administered and sold the program.

As might be expected, the mechanics of the "Donations Canada" Program were complicated. It was designed to enable Canadian taxpayers to obtain a financial benefit, by way of a tax deduction, that was almost twice the amount of their actual cash investment.

In a proposed class proceeding involving this arrangement, the plaintiffs allege that the program was also designed to reap substantial profits for those involved in the development, promotion and administration of the Program.

The Honourable Justice Strathy, in a motion decision relating to jurisdiction, described the operation of the program as follows:

> Canadian taxpayers… who participated in the Program made an initial payment to Parklane in increments of $2,500.00. This money was then paid by Parklane to Funds for Canada Foundation and ultimately to a registered charity participating in the Program. In return for this investment, the taxpayer would also receive two units in a sub-trust, valued at $3,750 each, for a total of $7,500. The taxpayer would then donate the sub-trust units to the same registered charity and would receive two charitable donation receipts, one a cash receipt for the $2,500 donation and the

other an in-kind receipt, for the donation of the sub-trust units valued at $7,500. For a taxpayer in the highest tax bracket, this would result in tax savings of $4,640 on a donation of $2,500, for a net cash return of 86%. Obviously, this was a very attractive "investment".

The charities that participated in the program were amateur athletic associations including the Canadian Amateur Wrestling Association, Little League Baseball Canada and the Canadian Five Pin Bowlers' Association. In order to participate in the Program, and receive the benefit of investor contributions, they were required to enter into agreements with some of the defendants that governed the use of the money they received through the Program.

As part of the arrangement made with the charity, Donations Canada Financial Trust then acquired the sub-trust units held by the charity for their assigned value, namely $3,750 each. The money that was used to acquire the sub-trust units was provided by the Trust.

This was presumably intended to satisfy CRA that the two sub-trust units in fact had a value of $7,500. However, the charity was not permitted to retain the $10,000 that it now had in hand. The arrangement between the Program and each charity required the charity to pay to Trafalgar Trading all but $100 of the $10,000, in exchange for participating in a long-term investment agreement which was supposed to provide the charity with an income stream over a number of years.

Of the remaining $9,900 paid by the charity to Trafalgar Trading, approximately $800 was paid to Parklane and was used to pay commissions to salespeople, the balance being retained by Parklane as profit. Trafalgar Trading retained $1,100, ostensibly for investing on behalf of the charities to provide a future income stream, and the balance, $8,000, was paid to the Trust.

Thus, for every $7,500 contributed by the trust, it received in return $8,000, usually in a matter of a few days, resulting in a profit of $500 on a very short term advance.

The upshot was that everyone was happy. The investor had effectively made a profit on the investment by achieving tax savings that substantially exceeded the amount of his or her "donation". The charity was happy, because it acquired $100 in real cash and what was promised to be a long-term income stream. Parklane and its sales staff were happy, because the salespeople received commissions and Parklane made a profit. Trafalgar was happy because it had funds for investment. The Trust was happy because it made a healthy profit on a short-term loan or investment. Presumably as the creator of the Program and a beneficiary of the Trust, was very happy. The trust's money went around in a big circle and at the end of the day, before commissions and expenses were paid, most of the investors' money was in the pockets of various participants in the program and the charities received only 1% of the total "donation".

Unfortunately, the happiness did not last, at least for the taxpayer "investors". The CRA disallowed their claimed deductions and they not only have they lost their "donations", but they have to repay CRA for the taxes owing, with interest.

The CRA asserted that the emperor had no clothes. It took the position that the "donations" made were not in fact "gifts". CRA stated:

We have concluded, based on our review of the flow of cash in the Donation Program that your cash payment is not a gift at law. While the cash was received by a designated charity, it is clear that this amount was never intended to be for the charity's exclusive use. In fact, the charity only retained 1% of the funds received. The charities were required to disperse [sic] the funds in accordance with agreements entered into as pre-requisites to becoming involved in the Donation Program. In addition, the promoter controlled and directed the flow of cash to the other entities by requiring the charities to sign documents transferring 99% of the

funds to Trafalgar Trading Ltd. Only after the bank transfers were signed and submitted to the promoter were the funds deposited to the charity's bank account.

Although, the charities allegedly invested 93% of the funds received in an investment contract, most of the funds ended up back in the hands of the Program "Facilitator" [the Trust] the same day. Trafalgar Trading Ltd retained only 15% of the funds they had committed to invest.

In addition, the charities, had no recourse to recover any of these funds. As a result the charities did not have unfettered use of the funds nor were the funds available to be invested for the benefit of the charities. This circular flow of funds was preordained with the intended result that the charity would never have use of these funds for its activities. The charities were simply conduits through which the funds were flowed in an attempt to generate the donation tax credit.

Finally, in most if not all cases, the donors did not know which charity from a pre-determined list would be the recipient of their donation. The promoter decided this at the time the funds were transferred to the charity.

A gift can not be perfected if the recipient does not have unfettered use of the property. Clearly the charity did not have unfettered use of the all the money for which the donation receipts were issued. Your cash payment was not a gift to the charity at all, rather was it a fee paid indirectly to the promoter to participate in the donation program.

Accordingly, the amounts you donated to a charity pursuant to the Donations Canada 2005 Donation Program are not allowed as deductions against Part I tax payable in 2005 nor in your subsequent taxation years.

The statement of claim in the proposed class proceeding references various opinion letters provided by large maritime law firm, which opinion letters concluded that the cash

and “in-kind donations” made by participants would qualify and be accepted by CRA as charitable tax donations.

CRA revoked the charitable registration of Funds for Canada Foundation effective August 8, 2009, concluding that:

> Based on the Canada Revenue Agency's (CRA) audit of Funds for Canada Foundation (the Charity), it is our view that the Charity operates for the primary or collateral purpose of furthering the Donations for Canada tax shelter by agreeing, for a fee, to act as a receipting agent in the tax shelter arrangement.
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> Our audit has revealed that from December 2, 2005, to December 31, 2006, the Charity issued nearly $176.5 million in receipts for cash received through the tax shelter arrangement. The Charity, in turn, paid over $14.2 million to the tax shelter promoter as fundraising fees and directed $160.8 million to an off-shore investment vehicle.
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> Our audit findings indicate that 79.05% of the funds directed to the off-shore investment vehicle were eventually returned to the original lender of the funds. The Charity retained a meager 1% of the total tax-receipted amounts for use in its own programs.

5. Banyan Tree Foundation Gift Program

Between 2003 and 2007 approximately 3,000 individuals participated in a leveraged charitable donation arrangement known as the Banyan Tree Foundation Gift Program.

The gift program was promoted, developed and administered by Promittere Capital Group Inc. and Promittere Asset Management Ltd. The program allowed participants to borrow 86.5% of the total amount to be donated with only 13.5% actually being provided in cash.

The promotional and marketing material in support of the program indicates that for each $1,000.00 donation, a donor contributes only $273.00 of actual out-of-pocket cash and receives a charitable donation tax credit of $464.00 (based on a combined Federal and Provincial tax rate of 46.4%). The $464.00 tax credit minus $273.00 of personal cash contributed, results in a net benefit of $191.00.

Of the $273.00 paid, $135.00 was donated to the Banyan Tree Foundation for the cash portion of the donation, with the remaining $138.00 said to be a security deposit invested to generate growth to repay the loan to be provided for the balance of the donation.

A loan was offered for 86.5% of the donation for a 10 year term bearing interest at 4.5% per annum.

Loans were provided by Rochester Financial Limited, a Canadian corporation whose sole purpose was to provide donor loans and manage security deposits.

The foundation used the cash portion of the donation to pay for fees and to promote and administer the gift program. The foundation purported to use the leveraged portion of the donation, i.e. the loan portion, to purchase 25-year term annuity contracts which would provide for annual payments for 25 years. The term annuity contracts were purchased from a British Virgin Islands company which earned a fee on the face value of the annuity contracts.

The foundation would then assign the majority of the term annuity contracts to certain Canadian charities.

Bank records indicate that Rochester obtained an overdraft for the amount of the loans from its bank and directed the funds to the foundation who then directed the amount to a lawyer’s trust account on behalf of the British Virgin Islands Company. The lawyer, upon receiving the funds in trust, directed the amount back to Rochester. Rochester repaid the funds to the bank thus completing a circular flow of funds.

A national law firm provided tax opinions in connection with the program.

The tax opinions provided:

> The opinions expressed in this letter may be relied upon by you, and by a Donor who is provided a copy of this letter by you, or the Donor's authorized representative and, may not be relied on by anyone else without our written permission. Each Donor should review this letter and their particular circumstances with their professional tax advisor.

The same national law firm involved in providing the tax opinion on the Banyan Tree Foundation Gift Program provided the initial opinion with respect to GLGI/Millennium and Canadian Humanitarian Trust.

CRA denied the charitable donation tax credits with respect to participation in the Banyan Tree Foundation Gift Program.

The Banyan Tree Foundation, the promoters of the program and the national law firm that provided the tax opinions are defendants in an ongoing class proceeding which has been certified by the Ontario Superior Court of Justice.

The lawsuit alleges that the tax opinions were a necessary pre-requisite to the promotion and sale of the program to participants. But for the tax opinions, the Banyan Tree Foundation Gift Program could never have been sold.

In all these gift program arrangements, CRA audited participants and disallowed the charitable donation tax credits claimed. CRA often took the position that the entire charitable donation tax credit amount was not allowed, however, in some cases CRA recognized the actual "out of pocket" cash paid by participants, as a valid charitable donation tax credit.

It is arguable that legal and/or tax opinions were a necessary pre-requisite to the development and promotion of all charitable gifting arrangements.

The favourable tax treatment received by participants was a fundamental element of such gifting arrangements.

While participants may in some cases have had valid donative intent, favourable tax treatment was obviously a key motivator for participation.

Maréchaux Decision

Max Maréchaux is a very experienced real estate lawyer with a respected Canadian law firm.

He claimed a tax credit in respect of a purported $100,000.00 gift to a registered charity made on December 31, 2001.

CRA reassessed his tax return for the 2001 taxation year disallowing the tax credit in full.

Maréchaux served a Notice of Objection to the assessment and filed an appeal to the Tax Court of Canada.

In *Maréchaux v. Her Majesty the Queen*, 2009 TSCC 387 (CanLII), the Tax Court of Canada dismissed the appeal concluding that the tax credit was properly disallowed because the $100,000.00 purported donation was not a gift.

Maréchaux participated in a gifting program which was a "leveraged donation program". The program was referred to as the 2001 Donation Program for Medical Science and Technology (the "Trinity Program"). Maréchaux was provided favourable financing for a large part of the donation.

The Trinity Program was implemented December 31, 2001 and was initially a small program with 118 participants and donations totaling more than $18.3 million.

Similar programs were promoted in 2002 and 2003. The total amount of the purported gifts made in the later years were $106 million and $94 million.

The promotional material for the program referenced a "tax opinion from a firm of respected tax lawyers".

Participants borrowed 80% of the pledge amount by way of a non-interest bearing 20-year loan. They made payment of the remaining 20% of the pledge from their own resources and also paid an amount equal to 10% of the pledge for fees, insurance and a security deposit.

All of the Trinity Program steps including the disputed loans, the flow of funds in the series of transactions that occurred, etc., were predetermined and interconnected.

The court pointed out in its analysis that a gift is a voluntary transfer of property owned by a donor to a donee, in return for which no benefit or consideration flows to the donor.

The court found that Maréchaux did not make a gift because a significant benefit flowed to him in return for the donation. The benefit was the financing arrangement. The financing arrangement was not provided in isolation to the donation. Indeed, the two were inextricably tied together by the agreements.

Maréchaux argued that the donation was made primarily for charitable reasons and that the tax savings were a secondary consideration. The court found that such a submission did not assist Maréchaux. The court said that even if Maréchaux's participation in the program was influenced primarily by a charitable motivation, once it is determined that he anticipated to receive, and did receive, a benefit in return for the donation, there is no gift.

The court furthermore found that even the partial "gift" consisting of the cash outlay was not truly a gift because on the facts there was just one interconnected arrangement and no part of it could be considered to create a gift that Maréchaux gave in expectation of no return.

Maréchaux appealed further to the Federal Court of Appeal. The matter was heard in late October 2010 by a three judge panel.

The appeal was dismissed. The Federal Court of Appeal upheld the decision of the Tax Court of Canada: *Maréchaux v. Canada*, [2010] F.C.J. No. 1337.

It is important to note that very little of the money donated under this program was actually retained by charities to advance their purposes.

For an expenditure of $30,000.00, Maréchaux received a charitable donation tax receipt for $100,000.00 and claimed a tax credit of $44,218.00, a potential return on his outlay of nearly 50% in a matter of months.

The *Maréchaux* decision indicates the attitude of the Tax Court of Canada and the Federal Court of Appeal towards these types of gifting arrangements.

Legal Opinions

Retainer Payment Arrangements

The author believes on good and reliable authority that some of the law firms who provided tax opinions in connection with gifting programs were retained and paid professional fees in a manner determined by the number of participants in and/or the total amounts donated under the gift programs.

If that is in fact the case, it is suggested that such arrangements put the law firms in an irreconcilable conflict of interest position where they have essentially become joint-venturers and joint-promoters of the gifting programs.

It is suggested that any such arrangements are on this basis alone sufficient to attract liability against the law firms.

In a recent trial decision, *Lemberg v. Perris*, 2010 ONSC 3690, the trial Judge found liability against an accountant relating to recommendation of a tax avoidance scheme that was unsuccessful.

The accountant was found to be in a fiduciary relationship with his clients.

The accountant received a commissionor fee from the sponsors of the program. His receipt of the commission/fee was not disclosed to his clients.

The court found that the accountant was working for the proponent of the scheme and that he had a financial interest in the transaction that was at odds with the interests of his clients.

The court found that the integrity of the accountant was impaired by self-interest and that his advice was not independent because he had a financial interest in the transaction, which financial interest was not disclosed.

Assumptions

Some of the legal opinions provided purporting to support the validity of charitable donation gifting arrangements assume certain important facts that are central to the issues under consideration.

Some of these opinions circumvent the complex issues pertaining to gifts because they assume that the donations are in fact gifts made to a charity. That is of course the very essence of the issue that will be reviewed and assessed by CRA.

Thus, the opinions are fundamentally flawed and misleading in that they assume several of their key conclusions.

General Anti-Avoidance Rule (GAAR)

Several of the legal opinions gloss over the consideration of GAAR. They point out what GAAR is and how it operates but conclude that GAAR does not apply.

It is difficult to understand how a GAAR discussion and analysis can be apparently easily dismissed in any situation where a participant in a charitable gifting arrangement receives a charitable donation tax receipt which has a value significantly greater than the actual amount donated by the participant. At a minimum, legal opinions should warn that GAAR may be invoked by CRA in such situations. Properly, legal opinions should indicate that there is a high likelihood that CRA will invoke GAAR and will very likely audit individuals who claim charitable donation tax credits for amounts significantly greater than the actual out-of-pocket cash outlay.

Involvement in Structuring the Program/Transactions

In some cases, the law firms that provided the legal opinions in support of the charitable donation gifting arrangements were also involved in structuring the actual programs. The law firms prepared the requisite documentation in the form of pledges, loan agreements, directions, etc., and, it is suspected, that in some cases the law firms were, through their work in structuring the Programs, possessed of knowledge and information which would indicate that the assumptions forming the basis of the legal opinions were not, in all cases, valid or accurate.

Tax Opinions are Marketing Documents

Lawyers (and other professionals) should anticipate that their opinions will be used to market gift programs to potential donors.

As CRA points out in its tax payer alerts, legal and tax opinions provided off and contained "very general comments" and do not provide unconditional support for this scheme." While that

may be the case, the average Canadian is not able to determine that when deciding whether or not to participate in a charitable gifting program.

It is clear that tax and legal opinions are obtained for purposes of lending credibility to the programs. Favourable tax treatment is a fundamental element of most such programs.

As in *Maréchaux* any valid donative intent is “trumped” by the expectation and receipt of any benefit in return for the donation.

The question that will have to be determined by our courts is whether law firms, accountants and other advisors should be held responsible in these types of situations, i.e., where they knew or ought to have known that the opinions provided were fundamental to the gifting programs being set-up, and would be used to lend credibility to the programs in promising favourable tax treatment for participants.

> “Some skeptics think the legal opinion has become just another commodity, tailored to the needs of the consumer, bought and sold in a competitive marketplace like any other product. Regard for ethics and the legal truth, these critics say, has been lost….
>
> Aggressive tax shelter opinions, helping the rich get richer and depriving the public treasury of funds needed for great public projects? That’s more difficult; most would think that such opinions are just part of a normal day’s work, but a very senior tax lawyer of my acquaintance, impressively, would have nothing to do with them on ethical grounds. Good for him.”[1]

[1] Philip Slayton, “Where to Draw the Line” Canadian Lawyer Magazine, January, 2010