Berg v The Queen, 2012 TCC 406

How is the intention to obtain a false and inflated donation receipt to be used to obtain an inflated tax credit related to the intention to donate?

[Decision has been overturned by *Canada v Berg,* 2014 FCA 25]

Berg v The Queen, 2012 TCC 406

At issue in this case was whether a taxpayer, who has made donations as part of an inflated donation scheme, could deduct any amounts as a donation at all? - ie does the overall scheme of the donation program (inflated gift receipt and bogus transaction documents) vitiate the donative intent of the transferred unit to the charity?

The Court held that one cannot conflate the *intention* to donate with the *motivation* or *purpose* for making the donation. In this case the court found as fact that the taxpayer intended to donate the cash amounts he provided and only expected a tax receipt for the donation. His motivation, which the court held to be irrelevant for determining if there was a "gift" in law, was to potentially obtain an inflated tax receipt that would result in an inflated tax credit. Two factors are determinative of this result: (1) both parties agreed that the only benefit was the inflated tax receipt, and (2) the taxpayer admitted (and the court accepted as fact) that the transaction documents were a sham and of no legal force and effect. As such the court allowed a tax credit, and accepted as valid gift, the cash amounts actually paid as part of the donation program.

DISCUSSION

[The discussion for this case will be added to in the future to provide a more complete understanding of the case law in relation to the donative intent question in charitable schemes]

With all due respect to Justice Brock, the decision in this case is wrong. Of course, the Court is limited in its ability to render a decision by the admissions of fact and counsels' arguments. In this case we see the difference able counsel makes.

The only distinction between this case and others involving leveraged donations is that in this case the taxpayer admitted that the transaction documents - ie the whole scheme - was a sham, and therefore the documents were of no legal force and could not provide a benefit to the taxpayer. The Court accepted this admission and conclusion, and thereby held that there was no benefit to the taxpayer other than the tax receipt and therefore the tax credit (which correctly in itself does not negate donative intent for purposes of the tax credit in section 118.1).

In this case the taxpayer admitted that he intended to deceive the CRA and hoped to defraud the government using fraudulent documents. What the Court in this case has done is, in effect, remove any downside for taxpayers engaging in leveraged donation schemes. Taxpayer are free (from a tax perspective) to create fraudulent documents (with no legal force but presented as having legal force to the CRA) for the purpose of defrauding the government and therefore throwing the tax burden on the rest of Canadians who honestly pay their taxes. If they succeed in their fraud, then they get the benefit of a tax refund at the expense of honest taxpaying citizens, and if they fail they get the benefit of their cash outlay as a tax credit so long as they admit that the documents were a fraud.

Such an admisssion admission will almost always be one of convenience, and it is beyond doubt that the taxpayer in such circumstances would insist that the document were valid in it was in their favour to make such a claim. In this case, the taxpayer would have insisted that the release was valid and binding, and did admit that this was his intention so as to protect him against a future attempt to collect on the promissory note. If the promissory note was not valid, then there would be no need to have a release. Where the taxpayer did not intend to defraud the government but was duped into believing that the scheme was valid deserves some sympathy while the intentional fraudster deserves none.

This decision brings to the forefront a tension in the case law. The tension is at heart not a legal tension, though it is manifest in the judgements as legal distinctions based on factual findings, but rather is a distinction based on pity. One the one hand, it appears that some judges "feel" for the taxpayer who does in fact spend money in circumstances where a charity received a benefit equal to the amount expended by the taxpayer, should at least get a credit for the actual amount expended. Other judges, however, appear to view that the intention to defraud the government through the use of inflated tax receipts is not worthy of sympathy, and provide no credit for the expenditures made in pursuit of the fraud.

The first set of judges, though motivated by good intentions, create harmful incentives. The road to hell, as the saying goes, is paved with good intention. In this case, the road to poor law is paved with good intentions.

A more fruitful question to try and answer, in determining the donative intent of the taxpayer, would perhaps be: Would the taxpayer have made the donation in question if the inflated tax receipt (and therefore the potential of a tax refund to offset the economic loss of donation amount) were not present?

FACTS

The taxpayer participated in a donation program and entered into a series of predetermined donation transactions with two corporations. The taxpayer bought a number of time-share units and paid for a portion with a promissory note while providing some amounts on signing and also later. At the same time as the promissory note, the taxpayer received a discharge of his obligations thereunder (this was part of the conditions under which the taxpayer agreed to participate). The same day the time share units were pledged as security for the obligations under the promissory note, and entered into a guarantee agreement with a third party (guaranteeing his meeting the Promissory note obligations) for payment of a guarantee fee. The timeshare units were then transferred to a registered charity who issued the taxpayer a receipt for the full value of the timeshares (much greater than the amounts paid) and in excess of the

FMV of the time-share units. The taxpayer then claimed the full value of the credit as indicated on the receipt.

The taxpayer never had an intention of paying the promissory notes, the pledge agreement and guarantee agreements were mere pretenses and did not reflect bona fide obligations of the taxpayer to the corporations involved - none of the guarantee fees were paid.

The MNR reassessed and disallowed claimed charitable gifts in the amounts of $2,420,000.00, $1,786,000.00 and $718,380.00 for the 2002, 2003 and 2004 tax years, respectively. The MNR didn't recognise the ability to deduct any amounts at all, including the cash portions. The minister said that there was no valid gift pursuant to section 118.1 of the ITA.

Taxpayer's Argument

The taxpayer argued that "the additional tax advantage sought by the taxpayer, whether legitimate or not, whether factual or pretense or whether accepted or rejected, cannot be considered a benefit received in exchange for the transferred units such that the tax advantage sought nullified the donative intent." (para 22). Seeking the ulterior result is concurrent with, without smothering the value of or the gift and receipt of the units to the charity. The taxpayer provided value for the transferred units, but no benefit was received by him from the charity or any other party.

The scheme embodies the concurrent donative intent, impoverishment of the taxpayer, and a unconditional gift of the cash donation amount to the charity without reciprocal consideration received by taxpayer. The case law, the taxpayer argued, doesn’t allow the conflation of the donative intent with the conflated charitable scheme.

The taxpayer argued that the proposed changes in 2003 relating to hybrid charitable donations anticipate that from a prospective policy perspective, that "Parliament recognizes that a benefit conferred on the donor and a valuable gift may exist concurrently within the “transaction”. (para 24). All the taxpayer was seeking was a ta receipt.

Crown's Argument

The Crown stated that the incentive of a tax receipt don't generally vitiate donative intent, but in this case the inflated values and other transaction documents, cumulatively, confer a benefit to the donor beyond the simple sought after inflated gift receipt. There was no intention that the taxpayer be impoverished by the gift to the charity. At the time of the transaction, there were benefits that existed and were critical in enticing the taxpayer to participate in the donation program.

ANALYSIS

The court here held that the taxpayer suggested preferred done charities and that the charity chosen was the one preferred by the taxpayer from a list of pre-selected charities, and that the transaction documents were window dressing only intended to fool only the tax authorities and not anyone else. The Court also held that to the taxpayer the matter looked authentic (though he knew that he was fooling the tax authorities).

The Court noted that subsection 118.1(1) doesn't define "gift", but that among other requirements its legally essential that a gift exist in law before the donated amounts can be claimed under the charitable tax credit. The court held that the taxpayer here had a twofold intention:

1) to maximise his tax donation receipt by executing all the documents places before him, and

2) to provide, and did provide, valuable consideration for the privilege of participating in the donation program (knowing that this was the price of entry).

He did not, however, intend the deductibility of the valuable cash consideration paid would ever be at risk because of the allegation that his donative intent was nullified or rendered non-existent by the donation program.

The Court made factual findings at paragraph 27:

> [27] Factually, the Court finds that the Appellant’s primary goal and motivation in “doing the deal”, as the Appellant himself describes the Donation Program, was to execute all such documents placed before him by the promoter (including the legally superfluous Discharges) in order to obtain a tax receipt nine times greater than the Cash Donation Amounts. As regards certain constituent elements of a charitable gift, the Court does find that the requisite need for a transfer and acceptance of the Transferred Units was satisfied. As well, unless the legal authorities direct that the Vitiating Facts, when existent, countermand the donative intent of the Transferred Units present in this case, then deductibility by the Appellant to the extent of the Cash Donation Amount is allowed under the Act.

The Court turned to the leading case of *Friedberg v. R,* 92 DTC 6031 (F.C.A.), to define "gift" as "a voluntary transfer of property owned by a donor to a donee, in return for which no benefit or consideration flows to the donor (see Heald, J. in *The Queen v. Zandstra*, [1974] C.T.C. 503, 74 D.T.C. 6416, at page 509 (D.T.C. 6420)). The tax advantage which is received from gifts is not normally considered a “benefit” within this definition, for to do so would render the charitable donations deductions unavailable to many donors." The FCA also used the example of donations of cultural property to say that it's possible to make "profitable" gifts (low cost but high FMV).

The Court here held that to the extent of the cash donation amount, the taxpayer factually and intentionally transferred the units to the charity "without expectation in advance, nor receipt subsequently, of consideration of benefit from the charity or third parties beyond the inflated gift receipts" (para 29). Since the gift receipts are not consideration for purposes of the donation credit, they do not vitiate donative intent. The property was owned by the taxpayer, he had the authority to give it away and he did give it away.

The TCC then referred to the decision in *Paradis v R*, [1997] 2 C.T.C. 2557, where the court said at paragraph 38 that it was not pertinent to consider the tax advantage to determine the validity of the gift under Quebec law, but all that matters is the legal relationship between the donor and the donees. The charitable gift receipts is not consideration, but only evidence that the gift was received by the charity, and the availability of the deduction doesn't depend on the charity issuing the receipt (though it is essential) but by the ITA. The tax advantage can't be considered when determining whether the done was impoverished. The court in *Paradis* also drew a distinction between a conditional gift and an unconditional gift - no link to the tax benefit in order to make the gift.

The TCC also considered the decision of itself in *Doubinin v. R.,* 2004 TCC 438, where the court stated that the motivation of potential tax benefits doesn't equate with consideration for the gift, because tax benefits are not considered a benefit. Thus, in the absence of some additional benefit or considerations, donative intent should not be impugned where the "underlying gift has some tangible property and is not otherwise co-mingled with a received tangible or potential benefit beyond the donation tax receipt; however inflated or unsupportable" (para 33).

However, even small collateral benefits have been held to be countermand to the intention to give. in *Maréchaux v. R*, 2009 TCC 587, (upheld by the FCA) where the collateral benefit was the financing arrangement of an interest free loan, along with expectation of a put option - both were not provided in isolation of the donation but were tied to the donation - and it was considered not appropriate to break up the transaction into a gift and something else. The TCC distinguished the case at bar from *Maréchaux*, on the basis that the financing was a sham and not legally effective but only camouflage - they gave rise to no legal rights, obligations, or benefits. The discharge of the obligation was not related to the gift, the court said, but only to protect the taxpayer from a non-existent obligation. The court held that the taxpayer's admission that the transaction documents were pretenses was relevant in the decision of whether there was a benefit beyond the inflated gift receipts.

The TCC also dealt with *Webb v Canada*, 2004 TCC 619, where the intention to donate was vitiated by the intention to receive a tax credit and a substantial refund to exceed the cash outlay for the receipt/ Webb read Friedberg to not extend to an attempt to claim a donation in excess of the donation actually made to not be considered a benefit in the context of what constitutes a gift. The TCC noted that *Webb* was under the Informal Procedure, and in that case the taxpayer received a repayment of 75% of his initial donation. The decision in *McPherson v. R.*, 2006 TCC 648, was distinguished by the Court because the taxpayer expected to receive a kickback. The same goes for *Norton v R*, 2008 TCC 91.

Lockie v R, 2010 TCC 142, was also decided under Informal Procedure. In that case the court referred to the decision in *Klotz v. R*., 2004 TCC 147, where it was said that the motivation of a tax benefit but that a charitable state of mind is not a pre-requisite to getting a charitable gift tax credit, and allowed the credit. *Lockie* was decided on the basis that the only benefit was the tax credit under the ITA.

The Court concluded that sine no benefit flowed but the charitable tax receipt, the court didn't need to determine whether the concurrent non-charitable motivation or non-charitable purpose present rescinds or demolished the donative intent related to the cash donation amount.

The Court also referred to the decision of the OCA in *McNamee v. McNamee*, 2011 ONCA 533, where in the context of an estate freeze which included a gift of shares, the court stated that one must not conflate intention with the underlying motivation or purposes - a gift does not require altruism. *Kossow v R*, 2012 TCC 325, considered the implication of *McNamee*, where the court found as a fact that the donation in that case was contingent on the interest free loan, and it was said that *McNamee* was a family law case and did not intend to change the definition of a gift, and in that case there was only one interconnected transaction. The Court here, said that *Kossow* didn't stand for the proposition that a gift is nullified by the sere magnitude of the fit receipts absent factual tangible or potential benefits conveyed on or received by the donor.

The court concluded that although the taxpayer was not overwhelmingly (or even only marginally) motivated by the donative intent on the transfer of the units to the Charity, factually he had the intention to give the units purchase with the cash amount without condition of receiving any benefit other than the tax receipt, however inflated. Here, both counsel agreed that there was no benefit other than the possibility of the overstated tax receipt and the inflated charitable tax credit. The cash donation amount impoverished the taxapayer, and he intended to give this amount to the charity - the cash donation amount met the donative intent test.

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