

If it seems too good to be true, it likely is

Avoid buy-low, donate-high tax shelters, CRA says

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Tuesday, November 21, 2006 Canada Revenue Agency's usual warning about buy-low, donate-high tax shelters was obscured this year by the income trust brouhaha. Its latest warning came down on Oct. 31, so promoters of "gifting" tax shelters were able to fly below the radar while the media were focused on trusts.

But with less than six weeks until year-end, it's now prime selling season for these dubious tax shelters.

The CRA warns of the "financial risks" inherent in gifting trust arrangements, leveraged cash donations and buy-low, donate-high arrangements.

"If it looks too good to be true, it might just be," CRA spokesperson Jaqueline Couture said yesterday.

In an Oct. 31 release picked up only by a few regional publications, CRA commissioner Michel Dorais warned consumers to "be wary of any ad that uses tax savings as a key selling point."

The CRA reviews all tax shelters and will challenge "any arrangement that does not comply with the Income Tax Act. We will audit the tax returns of investors who participate in these tax shelters."

Audits of gifting tax shelter deals from other years are now in progress. The CRA warns buyers not to interpret the fact they've not yet been reassessed as CRA acceptance of a deal.

Audits can take a year to conduct and the agency has three years from the date of an assessment to reassess taxpayers. Warnings and fact sheets issued each November from 2003 to 2006 can be found at www.cra.gc.ca.

The latest alert entitled "Warning: Tax shelter gifting arrangements are risky" notes a Supreme Court of Canada announcement of April 20, 2006.

The SCC advised it will not hear appeals of the decisions of the Federal Court of Appeal in the cases of Frank Klotz and Quinn, Tolley and Nash. Those involved buy-low, donate-high flipping arrangements in which artworks were purchased and donated to charities.

As with most such schemes, charities issued donation receipts three or four times higher than the actual price paid by donors.

The hoped-for tax refunds exceeded the donors' costs but the FCA says the value of donations must be limited to how much taxpayers actually paid for the art.

The Department of Finance tried to shut down these deals on Dec. 5, 2003. That's when it amended the Income Tax Act to clarify that the donation amount on which a tax credit is based must be reduced by any "advantage" related to the gift.

Despite this, "some donation arrangements continue to be promoted," the CRA says.

For donations before 2002, the CRA has reassessed 6,700 taxpayers, disallowing almost half a billion dollars worth of "donations."

For 2002, 5,700 others were audited for another \$360-million. For 2003, 1,800 taxpayers have been audited for \$66-million in disallowed donations.

"Generally, the CRA reduces the amount of the gift to no more than the cash paid by the taxpayer, and in many cases it is reduced to less than that," the alert says. "In some cases, it is reduced to nil, when the donation is not a true gift."

Some taxpayers are lulled into a false sense of security because promoters give them a tax shelter identification number. Such numbers are no guarantee claimed tax benefits will be realized. It just means the CRA can identify all tax shelters and those using them.

Accountant Cheryl Mont says gifting tax shelters are still being sold but "I would avoid them all."

Mont, of Toronto-based chartered accountants, Harris & Wright, says taxpayers may place too much reliance on the "tax opinions" of certain accountants or lawyers retained by promoters.

"Even if they've found some magic loophole, the government's intention is quite clear," Mont says. "These things not only have to fall within the letter of the law but must pass the smell test." Few in her experience pass that test. "They just don't make any sense. The government is quite able to pass retroactive legislation if there is something they need to plug."

Felix Leung of Toronto-based Felix Leung Certified General Accountants says promoters are trying to get accountants and tax professionals to help them sell their products.

One told accountants of an insurance option: "In case the CRA successfully challenges the case, the insurance would compensate the difference and penalties." Leung, who also sells mutual funds, added: "I am not promoting these shelters to my clients."

Jamie Golombek, vice-president of taxation for AIM Trimark Investments, says taxpayers have "so far lost every single reported case involving art flips."

Even if promoters come up with new loopholes, taxpayers still must consider whether the General Anti-Avoidance Rule (GAAR) will kick in regardless. GAAR means that even if a shelter may appear to work technically, "if it violates the spirit of the Tax Act, they could reassess you anyway," Golombek said.

Taxpayers should get professional tax advice from someone not affiliated with the promoters.

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