



September 16, 2003

**Private & Confidential**

Canadians Change the World, Inc.  
69 Yorkville Avenue, Suite 400  
Toronto, Ontario  
M5R 1B8

Dear Sirs:

**Re: Donations of Goods**

You have requested that we provide our views as Chartered Accountants experienced in income tax matters, on the relevant Canadian federal income tax consequences under the Income Act (Canada) (the "Act") in respect of transactions involving an individual resident in Canada (a "Donor") making a donation in kind of foods ("Food") to The World Job and Food Bank a non-governmental organization of the United Nations and Change Canada Charitable Foundation, collectively referred to as a "registered Canadian charity", as defined in subsection 248(1) of the Act, (the "Charity"). The transactions are described more particularly below.

Our views on income tax matters expressed in this letter are based on the provisions of the Act and the regulations to the Act (the "Regulations") as of the date of this letter, all specific amendments to the Act announced by the Minister of Finance prior to the date of this letter, including the Draft Technical Legislation and Explanatory Notes to Amend the Income Act released December 20, 2002 (the "Technical Bill"), and our understanding of the current administrative practices of the Canada Customs and Revenue Agency (the "CCRA").

**This letter does not address the laws of any province or foreign jurisdiction, nor does it address any tax issues other than tax issues arising under the Act. The views expressed in this letter are our views as Chartered Accountants experienced in income tax matters and are based upon and subject to the facts and assumptions set out below. Our views represent our considered judgement as to the tax consequences of the issues discussed, however, they are not binding on CCRA or the courts and we cannot provide any assurance that they will not be successfully challenged by CCRA. None of the views expressed are or should be construed to be legal opinions.**

**Summary of Facts**

We have been presented with the transactions set out below and are assuming that this Summary of Facts contains all of the relevant facts. We have not independently verified any of these facts.

The donation of Food described herein will be facilitated by Canadians Change the World, Inc. sponsors of the Canadian Hunger Relief Gifting Program (the "Hunger Relief Program"). Our understanding of the Hunger Relief Program may be summarized as follows:

1. A Canadian resident individual (the "Purchaser" and "Donor") will purchase from Canadians Change the World, Inc. (the "Vendor"), Food comprising long grain rice and/or red kidney beans and pure powdered barley grass at a price which is significantly less than the appraised fair market value of the foods.

2. The Purchaser/donor will execute a Purchase Acquisition Agreement that stipulates amounts, (i.e. \$1,700 x the # of units), payments, etc. The Donor will sign both a Deed of Gift to a Charity, (signed but not dated) and a Transfer Agent Agreement which will include the Power of Attorney and Direction from the Purchaser/Donor. The Power of Attorney and Direction will give the Vendor and Fraser, Milner Casgrain LLP, the authority to act as their Power of Attorney and Escrow Agent respectively to disburse funds, date and release the Deed of Gift and to transfer the Food to the Charity etc.
3. The Donor will acquire free and clear title to the Food and will at no time be required to donate any of the Food to any charity.
4. The Vendor, as facilitator, will, when requested, arrange with the Charity to accept the Food as a charitable donation from the Donor. The Donor will be required to execute the Deed of Gift to a Charity Form.
5. The Charity will issue an official charitable donation tax receipt in the name of the Donor with a dollar value equal to the fair market value of the Food donated. The charitable donation tax receipt will be completed in accordance with the requirements for receipts given in exchange for gifts in kind, as prescribed by subsection 3501(1) of the Regulations.
6. The Vendor will arrange the purchase of the Food on behalf of the Purchaser and its shipping to the location(s) directed by the recipient Charity.
7. The Charity will obtain an independent appraisal of the Food (the “Appraisal”), which will be conducted by a qualified independent appraiser. The Charity will also obtain a review of the Appraisal by a second qualified appraiser. The review will not give an opinion of the value but will review the qualifications of and the methodology employed by the first qualified appraiser.

We are not qualified appraisers and therefore we express no opinion in respect of the value of the Food. However, we emphasize that in order for an individual to successfully obtain the anticipated results from the purchase and donation of the Food, it is extremely important that the fair market value at the date of the donation to the Charity, be established by a qualified appraiser. (See further discussion below under heading “Civil Penalties” and the discussion under heading “Appraisal Value”).

You have asked us to assume for purposes of this letter that, for \$1,700, a Donor will purchase Food comprising approximately:

- 425-450 kg of rice and/or kidney beans in either 2 kg or 5 kg bags;
- 30-40 kg of powdered barley grass in 1 kg bags.

### **Summary of Proposed Transactions**

#### *(a) Background*

We understand that the Vendor’s is able to acquire Food at a substantial discount to the appraised fair market value of the Food.

#### *(b) Acquisition*

Canadian resident individuals will be offered the opportunity to acquire from the Vendor Food, at a substantial discount to their appraised fair market value. The Food will be

purchased and donated outside of Canada. If the Food never enters Canada, it will not be subject to GST. If the Food enters Canada, it will not be subject to GST provided that it is food. We are not scientists and therefore, can express no opinion on whether or not the items contained in the Food package are food.

#### *Donation*

You have informed us that you will arrange with the Charity to agree to accept the Food as charitable donations. We have not been asked to, nor have we independently verified with Canada Customs and Revenue Agency (“CCRA”), that the Charity has the status of a registered Canadian charity or other qualified donee for the purpose of issuing charitable donation receipts and have assumed that both Canadians Change the World, Inc. and the Donor will undertake the necessary due diligence to verify the status of the Charity.

In the event that the Donor subsequently donates the Food, the Charity will, based on the Appraisal, issue a charitable donation receipt to the donor in an amount equal to the aggregate fair market value, as at the date of the donation, for the Food donated.

### **Summary of Tax Consequences**

In respect of Food acquired by an individual resident in Ontario during 2003 and which the individual in turn subsequently donates to a Charity:

- the individual will be entitled to a combined federal and provincial tax credit. For a resident of Ontario the tax credit is equal to 46.41% of the fair market value of the donated goods.;
- the individual will have disposed of Food, which should be treated as personal use property; and
- the individual will realize a capital gain equal to the excess of the appraised fair market value over the cost to the purchaser which will be taxed. For a resident of Ontario it will be taxed at a maximum rate of 23.20%.

### **Income Tax Consequences of the Transactions**

Based on our understanding of the Act, the donation of Food as described in the transactions contemplated above should constitute a charitable gift of personal-use property by an individual to a registered Canadian charity or other qualified donee, and as such will entitle the donor thereof, to an income tax credit equal to the top combined federal/provincial tax rate in the province in which the individual is resident.

#### *(a) Charitable Gifts of Personal-Use Property*

The provisions of section 118.1 of the Act contain rules regarding the making of charitable donations and for determining the quantum of tax credits available to donors in respect thereof. The section provides that a charitable donation has been made, where a gift is made in any circumstance where (a) property is transferred by a donor to a registered charity or other qualifying institution, (b) the transfer of property is voluntary, and (c) the transfer of property to the institution is made without expectation of consideration or other return or benefit to the donor.

The types of property, which may be gifted, include capital property, depreciable property, leasehold interests, and personal-use property. Personal-use property is defined

in section 54 of the Act to include any property “owned by a taxpayer that is used primarily for the personal use or enjoyment of the taxpayer” or for the personal use or enjoyment of any “person related to the taxpayer”. In this context, “related” means related by blood, marriage or adoption.

Subject to the comments below, the Food when acquired by a Donor should be personal-use property of the Donor and as such is not subject to any limitation as a charitable donation.

*(b) Official Donation Receipts*

The provision of Section 118.1 of the Act and section 3501 of the Regulations thereto allow a registered charitable organization or other qualified institution to issue official donation receipts in respect of charitable donations. Where the donation is monetary, the receipt is the cash amount donated. Where the gift is in the form of property other than cash, the tax receipt issued by the donee cannot exceed the fair market value of the property at the time the gift was made. Regulation 3501 also prescribes other conditions in respect of such receipts, in particular, receipts for gifts of property other than cash, shall contain (i) the day the donation was received, (ii) a brief description of the property, and (iii) the name and address of the appraiser of the property, if an appraisal was done. We assume that the Charities are aware of this requirement and that you will monitor the receipts issued to ensure compliance with these rules.

*(c) Tax Credits*

Section 118.1 of the Act makes tax credits available to individuals in respect of charitable gifts. Individuals are allowed a tax credit at the lowest marginal federal rate of 16% for the individual’s first \$200 in charitable gifts in a given year, and a tax credit at the highest marginal federal rate of 29% for all other charitable donations. In addition, since each province, except the three territories, levies their own tax, a provincial charitable donations tax credit is calculated that will reduce basic provincial tax. Some provinces also levy a surtax as a percentage of provincial tax, however, in these provinces the provincial tax credit for donations may also reduce the provincial surtax. Thus, charitable gifts in excess of \$200 per annum made by an individual resident in Canada (except in the territories) generate a tax credit generally equal to the top combined federal/provincial tax rate, in which the individual resides.

*(d) Limitation on Tax Credits*

Under the Act an individual is entitled to tax credits for gifts to registered charities of up to 75% of that individual’s net income for the year plus certain other adjustments. One of the other adjustments is an additional amount equal to 25% of the amount of any taxable capital gain arising from the gifting of capital property. As the Food that is the subject matter of the donation referred to in this letter are capital property and a taxable capital gain will result from their donation the tax credit limit will be increased by 25% of such taxable capital gain net of any capital losses incurred in making other donations.

*(e) Capital Gain*

The Act provides that where there is a disposition of personal-use property and the cost or proceeds of disposition of personal-use property is less than \$1,000, no gain or loss would be recognized on the disposition. However, the Act excludes from these rules personal-use property that is “excluded property”.

“Excluded property” means:

property acquired by the taxpayer, or by a person with whom the taxpayer does not deal at arms length, in circumstances in which it is reasonable to conclude that the acquisition of the property relates to an arrangement, plan or scheme that is promoted by another person or partnership and under which it is reasonable to conclude that the property will be the subject of a gift to which subsection 110.1(1), or the definition “total charitable gifts”, “total cultural gifts” or “total ecological gifts” in subsection 118.1(1), applies.

In this situation, a donation of Food would meet the definition of excluded property. Therefore, a capital gain will be realized on the disposition of the Food. An individual in Ontario would pay tax, depending on their marginal rate, of up to a rate of 23.20% on the capital gain.

### **Tax Shelter Identification Number**

Section 237.1 of the Act provides rules relating to “tax shelters”. The definition of a tax shelter as amended by Bill C-28 includes a gifting arrangement and any property acquired by a taxpayer where statements or representations are made to the taxpayer that the aggregate of losses, deductions, federal tax credits and other prescribed benefits, which includes provincial tax credits resulting from the acquisition of the property will equal or exceed the acquisition cost of the property to the taxpayer. A tax shelter may not be sold without obtaining a tax shelter identification number in advance from CCRA and a taxpayer must file a prescribed form with his or her tax return in order to claim any deduction or tax credit resulting from the tax shelter.

As there is a possibility that the proposed transactions could be construed to be a tax shelter transaction, the Promoter has registered the transaction as a tax shelter. Donors must therefore include the tax shelter registration number in their income tax returns when claiming the tax credits resulting from a Donation. We have been advised that the tax shelter registration number is TS 068569.

Even though the proposed transactions are registered as a tax shelter, they do not constitute a “tax shelter investment” as defined in Section 143.2 of the Act. Therefore the donation tax credit that may be claimed by a Donor is not affected by the “tax shelter investment” rules.

### **Civil Penalties**

The Act contains provisions for civil penalties, which would apply to persons who plan, promote or sell to a taxpayer an arrangement that includes a false statement made for tax purposes.

It is important to note that the civil penalties are not designed to apply to purchasers of tax arrangements, but rather to third parties, which in this case may include the Vendor, appraisers, Charities and others who make false statements or omissions in relation to tax matters. For example, where the Vendor, Charity and appraiser conspire to fraudulently inflate the value of the goods. The penalty imposed on such third parties would in such cases be the greater of \$1,000 and the amounts receivable by the Vendor, Charity or appraiser in respect of the purchase and subsequent donation. However, the penalty could only be imposed where the third party cannot establish that the representations (an appraisal for example) were reasonable in the circumstances and was not made in good faith.

Clearly, under these provisions there is an onus on the Vendor, Charities and appraisers to ensure that the appraisal meets the required standard of “due diligence”. There are no prescribed guidelines, but presumably the qualifications of the appraiser (training, experience, membership in

respected appraisal organizations) are important, as would be the methodology employed by the appraiser and the thoroughness with which the appraiser conducted his or her appraisal. In our view, since the valuation of the goods is a subjective exercise, an appraiser is allowed to be “wrong” – even outside the limits prescribed in the legislation. What the rules do ensure is that the appraiser is not careless, ignorant or arbitrary. Although not required under the law, we suggest that as a matter of prudence, you should obtain two independent appraisals. Alternatively, you may suggest to the Charities that they may wish to obtain their own appraisals (although it would seem reasonable that a Charity be able to rely on an appraisal commissioned by someone else, provided it is independent and properly conducted). As a cost saving alternative, a “review” of the initial appraisal by a qualified second appraiser would likely suffice. The review would not give an opinion of value, but would review the qualifications of, and methodology employed by, the first appraiser.

### **CCRA Assessing Action**

CCRA is in the process of issuing notices of reassessment on many taxpayers that purchased works of art and donated it to charities. CCRA is taking the position that the fair market value of the works of art, which were donated was substantially less than the amount for which the donation receipts were issued. In many cases they have charged a gross negligence penalty as part of the reassessment, claiming that the valuation was negligent and that the taxpayer should have known that it was wrong. The reassessments of which we are aware are being contested by the taxpayers involved and have yet to be heard before a court of competent jurisdiction. It is therefore not possible to determine what the outcome of these cases will be, including the issue of whether or not negligence penalties can apply. However, based on a review of other court decisions involving gross negligence penalties, we are of the view that CCRA’s position concerning gross negligence of donors in these cases cannot be sustained.

### **Donor’s Due Diligence**

While the civil penalties noted above do not apply to Donors. The Act does contain penalty provisions for the filing of false statements or for the omission of information in a tax return. The penalty is equal to the greater of \$1,000 and 50% of the tax savings. A couple of recent cases regarding the donation of art highlight the fact that a purchaser’s conduct regarding the validity of the transactions and the value of the art are very important in determining whether or not penalties are warranted, when the value of the donated art is overstated. In particular, this would be in situations where the purchaser has acquired goods at a substantial savings relative to the appraised value.

A Donor who diligently ensures that they meet the various conditions noted herein, in particular, ensuring the appraisal relied upon is completed by an uninterested qualified appraiser, should be able to avoid and or successfully defend against penalties imposed for false statements or omissions.

### **General Anti-Avoidance Rule**

The Act contains a general anti-avoidance rule, which allows CCRA to re-characterize any transaction or a step in a series of transactions and ignore the legal effect of the transaction or step if it is held that the transaction or step would result in a tax benefit unless the transaction or step may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than to obtain the tax benefit. If re-characterized, the income tax consequences of the transaction, or series of transactions, will be computed as is reasonable in the circumstances.

The general anti-avoidance rule is a very broad rule and may have application to any transaction or step in a series of transactions that results in a tax benefit. Once a transaction or step in a series or

transactions has been determined to result in a tax benefit, the rule will have potential application unless it is determined that the transaction or step may reasonably be considered to have been undertaken or arranged primarily for bona fide purposes other than for the purposes of obtaining the tax benefit. However, even where the transaction or step in a series of transactions does not meet the exception for bona fide purposes, the rule will not have application where it may reasonably be considered that the transaction would not result directly or indirectly in a misuse of the provisions of the Act or an abuse having regard to the provisions of the Act read as a whole.

In this case, the proposed transactions rely on provisions of the Act which expressly determine the tax consequences that flow from the disposition of personal-use property and allow for the issuance of charitable donation receipts and the entitlement to tax credits in respect of charitable donations in respect of property other than cash. Therefore, it is our view that the proposed transactions do not result in a misuse or abuse of the provisions of the Act and as such should not be subject to re-characterization under the general anti-avoidance provision. We caution you that there are very few cases dealing with the application of the general anti-avoidance rules. The courts have just started to examine the general anti-avoidance rule and the views of the courts on the scope and application are not enunciated clearly. It should be noted that at the 2001 Canadian Tax Foundation Conference CCRA stated that GAAR has been found not to apply to transactions involving Donation Tax Credits. This position has also been confirmed in CCRA's Income Tax Technical New #22.

### **Analysis of Underlying Tax Issues**

Our views expressed above are based upon and subject to the following comments, which in turn are based upon certain assumptions regarding the Donor and the consequences of the proposed transaction.

#### *(a) Capital Gains Tax*

Section 69 of the Act provides that where a taxpayer disposes of capital property by way of an inter vivos gift, the taxpayer is deemed to have received proceeds equal to the fair market value of the property. To the extent that the fair market value exceeds the taxpayer's adjusted cost base of the property, the taxpayer would have a capital gain.

In order for the taxpayer to realize a capital gain, the Food must be first considered capital property and not trading property or inventory. Unless a Donor is a dealer, or is otherwise acquiring the Food with a view to earning income, it is our view that the Food should be capital property to the taxpayer. While, on a personal basis, a taxpayer may benefit on an economic basis by the proposed transaction, it is our view that the purchase of property for the purpose of a charitable donation does not fit within any traditional views as to what constitutes "trading" or an "adventure in the nature of trade", as is commonly used to distinguish between capital property and inventory. The taxpayer has no expectation of profit (as the term is used for income tax purposes), reasonable or otherwise, nor is the purchase made with any of the traditional "badges of trade".

Recent court cases have also confirmed that property purchased solely for the purpose of a donation does not constitute an adventure in the nature of trade.

#### *(b) Appraisal Value*

In our view, the most important issue is the reasonableness and general acceptability of the value determined by the appraiser for the goods. In particular, given the anticipated significant difference between the purchase cost and the appraised values, the appraisal value provides the most likely area for challenge by CCRA in respect of the donation being made. The general presumption of CCRA, being, how can a donor claim a tax

credit based on an appraisal value, when the donor has very recently acquired the property for an amount significantly less than the appraisal value.

Although the Act does not define “fair market value”, the generally accepted meaning is “the highest price, expressed in a dollar amount, that the property would bring in an open and unrestricted market between a willing buyer and a willing seller who are both knowledgeable, informed and prudent, and who are acting independently of each other”.

You have indicated to us that the Vendor has the ability to purchase the Food at a substantial discount to the appraised fair market value. The Vendor will in turn sell the Food to the Donor at a higher value, but one which is still at a substantial discount to the appraised fair market value.

The Federal Court of Appeal has held that one could make a “profitable” gift, at least in an economic sense. There have been a number of other cases involving similar situations where this same principle has prevailed. However, it should be noted that the appraised fair market values used have not in all cases been accepted by the courts in those situations and the values were adjusted to reflect the Judge’s findings as to “correct” value.

Therefore, it is critically important that you have evidence to support the fair market value of the Food donated. Recent sales of similar goods at both the retail and wholesale levels, though not determinative, would also be helpful. The existence of such evidence, along with at least one, preferably two independent appraisals by qualified appraisers, provides strong support for the fair market values used for purposes of the charitable donation receipt.

**Conclusion**

For Food acquired by an individual and subsequently donated, the individual resident in Ontario should be entitled to a tax credit equal to approximately 46.41% of the fair market value of the Food.

This opinion is specifically directed toward individuals. Different considerations may apply to trusts, partnerships, corporations or other entities.

Yours very truly,



CHARTERED ACCOUNTANTS  
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