

# Case Comment: Profitable Donations— What Price Culture?\*

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In 1977, the federal government created an administrative framework to regulate the import and export of important cultural property and encourage its transfer to public hands. The legislative initiative was voiced in the *Cultural Property Export and Import Act*<sup>1</sup> (the “CPEIA”) with a significant echo in the *Income Tax Act*<sup>2</sup> (the “ITA”). Though the Department of National Revenue, Taxation and the Department of National Revenue, Customs and Excise have links to the CPEIA, the Minister of Communications reports to Parliament with respect to the Act’s administration.<sup>3</sup>

The scope of the CPEIA is indicated by its title: “An Act respecting the export from Canada of cultural property and the import into Canada of cultural property illegally exported from foreign states”. It permits the Canadian monitoring, supervision and control of the international flow of cultural property and emphasizes the desirability of retaining such property in Canada to preserve the national heritage. Only certain aspects of the CPEIA will be highlighted for the purposes of this discussion.

## Export of Cultural Property

The CPEIA regulates the export of moveable cultural property. Objects of archaeological, prehistorical, historical, artistic or scientific interest which meet specific valuation and other criteria may be included on the Canadian Cultural Property Export Control List,<sup>4</sup> at which point they may only be exported if an export permit is obtained through a designated officer of the Department of National Revenue, Customs and Excise.<sup>5</sup> As part of the process of obtaining a permit, an “expert examiner” may determine if the object is of “outstanding significance by reason of its close association with Canadian history or national life, its aesthetic qualities, or its value in the study of the arts or sciences; and whether the object is of such a degree of national importance that its loss to Canada would significantly diminish the national heritage”.<sup>6</sup>

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It should be noted that there are objects which may not be included on the Control List. The most important limitation is the prohibition against objects less than 50 years old or objects made by a person still living.<sup>7</sup> Also generally precluded from inclusion in the List are objects of “decorative art” that were made in territory that is now Canada and that are less than 100 years old. Decorative art includes glassware, ceramics, textiles, woodenware, works in base metals, furniture, wood sculptures, and works in precious metals.<sup>8</sup>

If an object is on the Control List, it may not be exported for two years unless an application is made to reduce this waiting period.<sup>9</sup> A request can be made to a special body created by the CPEIA, the Canadian Cultural Property Export Review Board (the “Review Board”), to review the application for the export permit.<sup>10</sup> If the Review Board determines that the object is of outstanding significance and national importance but thinks that a “fair offer to purchase” might be made by an institution or public authority in Canada, it may establish a delay period of two to six months.<sup>11</sup> Institutions and public authorities may then be notified that the export of the object has been delayed.<sup>12</sup> An “institution” would include a public museum or gallery, while a “public authority” would include the federal, or a provincial or municipal government or any arm thereof.

An institution or public authority may then offer to buy the object and, if the offer is not accepted, the Review Board may be requested to determine “the amount of a fair cash offer to purchase”.<sup>13</sup> If no offer is forthcoming, the object may be exported without any further delay.

If an institution or public authority offers to purchase the object for the amount of the fair cash offer determined by the Review Board, export of the object continues to be delayed for the remainder of the two-year period referred to earlier.<sup>14</sup> The purpose is to encourage owners and institutions to reach an agreement transferring the cultural object to a Canadian institution.

To assist in the purchase of these objects, the CPEIA permits government grants and loans to institutions and public authorities.<sup>15</sup> The annual budget for loans is \$30,000 and only two loans have been made to date. The CPEIA also creates a special government account called the Canadian Heritage Preservation Endowment Account to be credited with all moneys received by the government for the purpose of making the grants or for the purchase of similar property outside of Canada.<sup>16</sup> This account has not yet been used as it has been perceived by institutions to be a potential competitor for donated funds. This view may change, however, as donations become even more difficult to obtain. The account may eventually be perceived as a possible source of additional funds.

## **Donation of Cultural Property**

While the CPEIA raises barriers to the export of objects in the hope that they will remain in Canada, the ITA creates positive incentives for retention by including cultural objects in the provisions relating to gifts which have a favourable tax result. The ITA permits corporate taxpayers to deduct the value of certain gifts in the computation of their taxable incomes<sup>17</sup> and permits individuals to claim a credit against tax payable.<sup>18</sup>

Gifts are divided into three categories: charitable gifts<sup>19</sup>, gifts to the Crown<sup>20</sup> (the federal or a provincial government), and cultural gifts to institutions.<sup>21</sup> The first category, which includes gifts to registered charities, registered Canadian amateur athletic associations, and municipalities, limits the amount of the deduction or credit to a maximum of 20 per cent of a taxpayer's income.<sup>22</sup> This 20-per-cent limit does not apply to the last two categories: gifts to the federal or provincial governments and cultural gifts to an "institution or public authority" in Canada designated under section 32(2) of the CPEIA.<sup>23</sup> For these types of gifts, deductions or credits may be utilized up to the total income of the taxpayer. It would appear that a donation to the Canadian Heritage Preservation Endowment Account would be a gift to the federal government.

Moreover, cultural gifts to an "institution or public authority" have the additional advantage of being deemed not to result in a capital gain to the donor,<sup>24</sup> whereas ordinary gifts may result in a capital gain.<sup>25</sup>

These tax incentives, which were established so that private owners of cultural property of importance to the national heritage would find it advantageous to donate to Canadian institutions, provide a tax benefit much greater than that which can be derived from making a cash contribution to the same institution, or to any other deserving cause.

An explanation for this fiscal largesse may be found in the previously noted history of the Review Board, i.e., it was established to help keep cultural objects of national importance in Canada and, indeed, to help fund their purchase by Canadian institutions. A particularly favourable tax treatment was designed to encourage the owners of such objects to donate them to specific Canadian institutions, thus keeping them in the country and avoiding the need for public funding.

There was evidently no attempt to weigh the benefits accorded cultural donations against those for ordinary charitable contributions although, clearly, greater tax benefits would be likely to generate increased giving to all charities, thus reducing some of the calls for assistance made on all levels of government.

## **Expansion of Board Powers**

The authority of the Minister of National Revenue (the Minister) to assess taxpayers extends to all matters necessary to determine liability for tax,

including the value of charitable contributions.<sup>26</sup> Appeals from the Minister's assessment are now heard exclusively by the Tax Court of Canada subject to review by the Federal Court of Appeal.<sup>27</sup> Decisions of other courts or tribunals concerning issues of relevance to other than tax purposes such as the amount of maintenance payable or the basis of damages for breach of contract, would normally be accepted by the Minister or the Tax Court as conclusive.<sup>28</sup>

However, the Review Board now has the unique power to determine a purely tax issue and its decision is binding on the Minister at the time of assessment. Because of its expertise in identifying objects of significant cultural value, the Board's duties at the time of its inception included the certification for tax purposes of objects donated to Canadian cultural institutions. The objects had to meet the same tests of "outstanding significance" and "national importance" which are applied by the Review Board in its regular role. Effective as of February 1990, subsection 118.1(10) of the ITA has been amended to increase further the Board's powers by requiring it to determine the fair market value of cultural objects for tax purposes.

While a reduction of the Tax Court's powers to value cultural donations has not been specifically referred to in the legislation, it is assumed that the Review Board's conclusions are not reviewable by the Tax Court.

The rationale provided in the Budget papers for the amendment was as follows:

In addition to determining whether an object is Canadian cultural property, the Board provides an estimate of the value of the object for income tax purposes. In view of the expertise of the Board and its impartiality in determining such valuations, a more formal legislative base is proposed for the Board's role. The Board will be given the legislative responsibility for determining the fair market value of objects that it certifies to be Canadian cultural property. While this measure has no revenue implications, it will ensure a fair and streamlined administration of the rules governing gifts of certified Canadian cultural property.<sup>29</sup>

A survey of the Review Board's composition indicates that it is clearly a specialist tribunal. Apart from the chair and two other members chosen "generally from among residents of Canada", five members are, or have been, "dealers in or collectors of art, antiques or other objects that form part of the national heritage" and another five are "officers, members or employees of art galleries, museums, archives, libraries or other similar institutions".<sup>30</sup>

The CPEIA requires the Review Board to dispose of matters as informally and expeditiously as possible.<sup>31</sup> It is not bound by rules of evidence and although it is empowered to make rules for the conduct of its proceedings,<sup>32</sup> it has not yet done so. As well, it may obtain advisory assistance from any person who has special knowledge and it may also retain valuation experts.<sup>33</sup>

It must, though, “make the substance of any information received by it in respect of a matter before it known...to the person, institution or public authority that applied for a determination” and allow representations to be made in respect of that information before making a decision.<sup>34</sup> This is, of course, a statutory rendering of one of the fundamental rules of natural justice.

The additional power to value cultural donations for income tax purposes was accompanied by a power to redetermine fair market value where additional relevant information becomes available to the Review Board.<sup>35</sup> While there is no time limit provided, the ITA provides time limits for reassessments.<sup>36</sup> Accordingly, all redeterminations should be made within three years of the date of the assessment for the year.

In this context, the Review Board was also given the authority to communicate, to the Department of National Revenue, information obtained under the CPEIA for the purposes of administering the ITA.<sup>37</sup>

As indicated in the quoted Budget rationale, the Review Board had been informally reviewing fair market values prior to the acquisition of its new authority. Requests for certification were usually accompanied by valuations. Approximately \$60 million in certificates has been issued by the Review Board each year. Of the 700-800 applications received annually since 1977, approximately 10 to 15 per cent required further discussions. About half of this group were settled by agreement with the Review Board, with the remainder being left for review by Revenue Canada.<sup>38</sup> The number of applications has been increasing, reaching 1158 in 1991. This may reflect the lack of tax reduction opportunities available elsewhere.

The Review Board’s refusal to certify cultural significance has never been challenged. As previously indicated, the new jurisdiction of the Review Board is not regulated by a formal procedure. In an effort to maintain the specialist, consultative and collegial nature of the Board’s practice and discourage reference to the courts, the legislation minimizes the judicial nature of the Board’s function. An example of this role is its power to value objects which an applicant only proposes to dispose of to an institution; courts do not normally make a determination if a citizen is only considering a course of action. Indeed, even Revenue Canada is reluctant to give rules on valuations in transactions which are only being contemplated.<sup>39</sup>

The Review Board has a hybrid function, serving the cultural community, taxpayer benefactors, and Revenue Canada. Its new powers are to be seen in the context of its original purpose of keeping cultural property in Canada and facilitating the transfer of such property from private to public hands. In this light, it is appropriate to avoid the traditional adversarial process found in our courts. On the other hand, there is a danger in reducing adversarial scrutiny. The valuation difficulties which point to a co-operative approach, such as the

limited number of experts and the non-arm's-length relationship (if not conflicts of interest) among donors, institutions, and valuers, also suggest that Revenue Canada's sometimes Philistine eye may also be necessary. This difficulty was demonstrated by the Federal Court of Appeal decision in *Her Majesty The Queen v. Albert D. Friedberg*.<sup>40</sup>

### **Profiting by Donating**

In the *Friedberg* appeal, the Review Board had certified, as being of outstanding cultural significance and national importance, over 1000 pieces of antique Islamic textiles from the Middle East. These had been acquired over three generations by a family of dealers in Cairo who moved to New York. They were offered to the Royal Ontario Museum in Toronto for (U.S.) \$67,500.

Mr. Friedberg was willing to buy the textiles and then donate them to the Museum to obtain the deduction under the ITA (at the time the donation was made, the ITA still provided for deductions for individuals). The Federal Court of Appeal found that on the facts, legal title to the textiles had gone directly to the Museum.

This was significant because the Museum had obtained appraisals valuing the textiles at \$528,125, \$412,000 and \$538,000 and Mr. Friedberg had claimed a deduction based on these valuations rather than what he had paid. As he could not donate what he had never owned, the decision meant that, instead, he would be entitled to a deduction of (U.S.) \$67,500. [The Supreme Court of Canada has refused leave to appeal this decision.]

Following this transaction, Mr. Friedberg was more successful with a second collection of Coptic (i.e., Egyptian Christian) textiles which had been offered to the Museum for (U.S.) \$12,000. The Court found that he had obtained title to these before donating them to the Museum and was therefore entitled to a deduction of \$229,437 based on appraisals of \$142,650, \$305,000, and \$240,000, even though he had only paid (U.S.) \$12,000.

The Court concluded that it was possible to make a "profitable" gift in the case of cultural property which had a low acquisition price but a high fair market value because the tax benefits of the gift were greater than the cost of acquisition.

This windfall would be justifiable if the difference between the acquisition cost and the fair market value resulted from normal price escalation after purchase or a fortuitous acquisition from a third party. It is more difficult to accept the result when the taxpayer is doing nothing more than funding the acquisition. While a result such as this would undoubtedly encourage cultural donations, the cost to the taxpayers of Canada would appear to be excessive, particularly during difficult economic times.

If special tax concessions are appropriate to encourage Canadian cultural donations, perhaps these benefits should apply to gifts which have a greater significance to Canadian culture than antique Middle Eastern textiles. In this regard, Revenue Canada has announced that artists or their estates who donate their culturally significant work to institutions will be able to claim a tax credit based on its fair market value without that value being included in income.<sup>41</sup> This will enable artists to benefit from the value of their art without having to pay tax on it and will permit the creators of Canada's cultural heritage to benefit from extraordinary tax advantages rather than limiting such advantages to those who are merely fortunate enough to be in a position to fund acquisitions.

### FOOTNOTES

1. *Cultural Property Export and Import Act*, R.S.C. 1985, c. C-51.
2. *Income Tax Act*, R.S.C. 1952, c. 148, as amended.
3. *Supra*, footnote 1, s. 2 and s. 52, as amended and SI/84-172, registered September 5, 1984, *Canada Gazette*, Part II, Vol. 118, No. 18, p. 3599, pursuant to which the Minister of Communications was designated "Minister" for purposes of the *Cultural Property Export and Import Act*.
4. *Ibid.*, s. 4.
5. *Ibid.*, s. 5.
6. *Ibid.*, s. 6 and s. 11.
7. *Ibid.*, s. 4(3).
8. *Ibid.*, s. 4(2)(c).
9. *Ibid.*, s. 16.
10. *Ibid.*, s. 29.
11. *Ibid.*, s. 29(5).
12. *Ibid.*, s. 29(7).
13. *Ibid.*, s. 30.
14. *Ibid.*, s. 30(5).
15. *Ibid.*, s. 35.
16. *Ibid.*, s. 36.
17. *Supra*, footnote 2, s. 110.1.
18. *Ibid.*
19. *Ibid.*, s. 110.1(1)(a), in respect of corporations and the definition of "total charitable gifts" in s. 118.1(1) in respect of individuals.
20. *Ibid.*, s. 110.1(1)(b), in respect of corporations and the definition of "total Crown gift" in s. 118.1(1) in respect of individuals.
21. *Ibid.*, s. 110.1(1)(c), in respect of corporations and the definition of "total cultural gifts" in s. 118.1(1) in respect of individuals.
22. *Ibid.*, s. 110.1(1)(a), in respect of corporations and the definition of "total gifts" in s. 118.1(1) in respect of individuals.

23. *Ibid.*, s. 110.1(1)(c), in respect of corporations and paragraph (b) of the definition of “total cultural gifts” in s. 118.1(1) in respect of individuals.
24. *Ibid.*, s. 39(1)(a)(i.1).
25. *Ibid.*, s. 39(1)(a).
26. See, for example, *Stewart and Dilabio v. Minister of National Revenue*, 90 D.T.C. 1110 (T.C.C.) at 1112 where the jurisdiction of the Tax Court of Canada to decide collateral matters is discussed. In countless Valuation Day cases, for example, the Tax Court of Canada has not hesitated to determine the value of property as at December 31, 1971.
27. *Supra*, footnote 17, s. 169, as amended, and *Federal Court Act*, R.S.C. 1985, c. F-7, s. 27(1.1), as amended, in respect of appeals from judgments of the Tax Court of Canada (General Procedure) and *Federal Court Act*, R.S.C. 1985, c. F-7, s. 28, as amended, in respect of appeals from judgments of the Tax Court of Canada (Informal Procedure).
28. See, for example, *Barrie Richardson v. Minister of National Revenue*, 88 D.T.C. 1134 (T.C.C.).
29. *The Budget: Supplementary Information*, Department of Finance, February 20, 1990, p. 171.
30. *Supra*, footnote 1, s. 18(2).
31. *Ibid.*, s. 28.
32. *Ibid.*, s. 24.
33. *Ibid.*, s. 22.
34. *Ibid.*, s. 26.
35. *Ibid.*, s. 30(5).
36. *Supra*, footnote 17, s. 152(4), as amended.
37. *Supra*, footnote 1, s. 33(2), as amended.
38. See the *Annual Report: Cultural Property Export and Import Act*, Communications Canada, published for each year from 1979-1980 to the current year.
39. See paragraph 14(f) of *Information Circular No. 70-6R2*, “Advance Income Tax Rulings”, September 28, 1990.
40. *Her Majesty the Queen v. Albert D. Friedberg*, 92 D.T.C. 6031 (F.C.A.). [The author was counsel for the Crown in the appeal.]
41. The Review Board will also oversee this process. See *Department of Finance Release No. 91-050*, dated May 23, 1990.