Viewpoint

Dolphins, Tuna and Mudsharks: Reflections on the "Bre-X Budget" for Charities

BLAKE BROMLEY
Blake Bromley Consulting Inc., Vancouver, and Member, British Columbia Bar

The Bre-X saga has dramatically demonstrated to Canadians the short-term rewards and ultimate tragedy of allowing unsubstantiated claims of unmined treasure to escalate into destructive fantasy because there has been no objective exercise of due diligence by independent professionals. There are disturbing parallels when one contemplates the charity provisions in Minister of Finance Paul Martin's February 18, 1997 Federal Budget. Just as the Bre-X stock market play produced huge rewards for sophisticated players without an ounce of gold ever leaving the ground, so too in what might be called the "Bre-X Budget", votes are being courted and won without any hard evidence of increased funding for charities. For example, the new tax incentives encourage donors to donate gifts of shares (even highly speculative shares like Bre-X), rather than cash because they are publicly traded. Far worse, charities are now effectively denied the ability to receive gifts of debt obligations and shares in private Canadian companies no matter how secure and conservatively valued they may be. With great fanfare and hosannas for the Minister of Finance, the Bre-X Budget offers Canadian charities the fools' gold of publicly traded shares while silently taking back the motherlode of private corporate wealth.

The Bre-X Budget has received uncritical reviews which have produced political benefits for the Minister of Finance which parallel the financial benefits reaped by the promoters of Bre-X. The reviews by fund raisers and charities umbrella groups which hope to benefit from this budget are as laudatory and devoid of due diligence as the promotion of Bre-X by uncritical stockbrokers and investment analysts. Nevertheless, a close reading of the fine print in the published reviews of some of the accounting firms discloses a

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note of caution about the regulations governing loanbacks akin to the feeble notes of caution which some investment brokers sounded when the Suharto family tried to muscle its way into ownership of Bre-X. However, the stated concerns were considered applicable only to private foundations in the sideshow outside the big tent, so they were largely ignored and elbowed aside in the cacophony of acclaim for the main attraction in the centre ring of this political circus.

Bre-X Provision

The only aspect of the February 18 Federal Budget proposal that the politicians want to talk about is the "Bre-X Provision" which reduces the donor's inclusion rate of capital gains from gifts of securities listed on prescribed stock exchanges to 37.5 per cent. The budget speech and accompanying documents proudly proclaim that this provision will generate $95,000,000 in new charitable donations in each of the five years during which this donation incentive is temporarily available. Like any good stock promotion, there is no reference to the potential downside. Budget documents publicize the potential savings of Part I tax under optimum circumstances without disclosing anything about the impact of minimum tax on gifts of appreciated securities. A donor making a gift of securities with a capital gain of $1,000,000 triggers a minimum tax bill of nearly $100,000 assuming the donor has only the minimum exemption of $40,000. The donor cannot use any excess donation receipt from this or prior gifts to avoid the minimum tax. It will be important for charities soliciting gifts of appreciated securities from elderly persons with substantial assets but extremely modest annual incomes to advise them of this potential downside. There is a danger that such donors will be seduced by projections of tax savings in 1997 and then have a rude introduction to minimum tax in April 1998.

Resolution 21 Penalty Taxes

Unfortunately, the most profound impact on charities of the Bre-X Budget is not the reduction of the capital gains inclusion. Rather, it is the introduction of new penalty taxes in Resolution 21 which effectively prohibit gifts of private corporation shares or debt and also prohibit the donor from ever subsequently making use of any property given to charity even if fair market value is paid to the charity. Resolution 21 creates a tax on the recipient charity equal to 50 per cent of the amount of any gift made after February 19, 1997 by any donor or corporation that does not deal at arm's length with the donor if, within five years after the date of the gift, the recipient charity owns a share (other than a share listed on a prescribed stock exchange) of any corporation which does not deal at arm's length with the donor or holds any debt obligation of the donor or a non-arm's length person or corporation. (The actual provision

contains other issues and cannot be reduced to a single comprehensible sentence.)

Resolution 21 is intended to prevent the gift of private company shares and debt obligations of private corporations to charities. Finance officials are particularly hostile to private foundations but the net is cast so as to encompass all charities. When it was pointed out to Finance officials that the net caught all charities but not Crown foundations, their response was that they would attempt to include Crown foundations in these restrictions. It is very clear that Resolution 21 is intended to prevent the donation of debt instruments and shares in private Canadian corporations by entrepreneurs to any part of the charitable sector and not just to private foundations. Meetings with Finance officials subsequent to the Bre-X Budget make it clear that it is a considered policy decision to deny charitable donation tax credits to donors making charitable gifts of shares in private Canadian companies. This is the *quid pro quo* for the Bre-X Provision.

Finance officials know full well that the motherlode of Canadian wealth is held in private corporations built by Canadian entrepreneurs. In the months subsequent to the February 18 Federal Budget, newspaper accounts have advised the public that entrepreneurs such as the Bronfmans and Jim Pattison have made public offerings to take their public companies private. Resolution 21 will deny these entrepreneurs the right to donate to Canadian charities the shares of the resulting profitable private companies just as it denies Canadian charities the right to solicit shares of the private companies of the vast majority of lower profile Canadian entrepreneurs. The owners of publicly traded securities are seldom wealthy entrepreneurs but are more likely to be salaried income earners who cannot afford to give them away; pension funds which have no authority to give them away; and elderly people who hold them as a modest retirement nest egg. While there is some increased tax incentive to donate publicly traded shares, public shares are only a small fraction of the wealth represented by shares in private corporations which can no longer be donated.

Entrepreneurs Give Assets

The statements made by Paul Martin, when presenting the Budget, about the need for charities to receive gifts other than cash are absolutely correct. Among large donors there has been a paradigm shift away from cash donations. This is not because such donors are opposed to giving cash. It is because the large donor of the 1990s is no longer primarily the wealthy dowager living on income from family trusts or the business person who has sold the active job-creating business and converted the resulting wealth into a passive market investment portfolio. Instead, the new capital donors are active entrepreneurs

still operating their companies. This new breed of donor is cash poor because the cash is tied up in the company and is providing the capital necessary to employ people and stimulate growth. In recent years sophisticated gift planners have shown such people how to commit large amounts of capital to charity *and* maintain access to it for their business purposes. This planning has resulted in many tens of millions of dollars being donated to the charitable sector. Without this planning, many entrepreneurs who are asset rich but cannot give cash, simply sit on their wallets. Operating charities have more difficulty than Finance officials in recognizing this shift because the capital is most often donated to a private foundation.

Most wealthy Canadians prefer to structure these gift transactions with a private foundation rather than a public charity. This is partly for reasons of privacy and convenience. More importantly, these transactions most commonly involve seven-figure donations that would not be made if they were to go to only one organization or to be spent immediately. These entrepreneurs have heeded the call for the kind of long-term sustained stable charitable funding which comes from holding endowments and paying out annual returns to operating charities. Statistics provided by such authorities as Patrick Johnston, President of the Canadian Centre for Philanthropy, support the fact that charitable funding is coming from fewer donors who are digging deeper. It is those donors who are digging the deepest who are being targeted by Resolution 21. Most of these donors do not want to involve public charities in any business or loanback transactions. If they cannot donate cash, they will consider involving only the most sophisticated charities. However, the only realistic expectation that small struggling charities have of gaining access to this entrepreneurial wealth is through the intermediary of the entrepreneur's private foundation.

Finance officials see the future impact on their revenues if this trend continues and increases among entrepreneurs. Unlike the vast majority of operating charities which are never directly involved in these transactions, they know how generously wealthy Canadians have donated gifts of capital assets to charity in recent years. Such donations have not only generated a large charitable donation tax credit in the year of the gift but all future income and capital appreciation has taken place in the charity without being subject to further taxation. Resolution 21 has been introduced to divert Canadians' attention to the fantasy of the Bre-X Provision as Finance surreptitiously removes the present access to the motherlode of Canadian wealth represented by the companies of Canadian entrepreneurs. Finance has access to the same demographic data as charities and knows well how much wealth must change hands in the coming years as the current generation of entrepreneurs dies.

Allegations of Abuse

This policy shift, designed to deny the charitable sector access to private corporate wealth, is not being accomplished only by diverting the charitable sector's attention to the chimerical illusion of wealth in public shares. Finance officials are simultaneously embarking on a campaign of denigrating and disparaging Canadian philanthropists who give shares or debt obligations in their corporations. What were originally stage whispers about unidentified "abuse" have risen to a chorus of allegations about prevalent and predominant misuse and abuse of charitable giving provisions by private foundations. Finance officials have learned that they can, with impunity, cast aspersions on wealthy donors and private foundations as such people have no political support and no effective representation in the councils of umbrella organizations in the charitable sector. When pressed for concrete examples, the officials always hide behind the statutory requirement of secrecy which forbids identifying specific cases. However, one is left with the unmistakable inference that only a rogue would doubt that these officials are protecting the charitable sector from abuse. They are far too clever to let the public realize that they are actually denying charities the financial resources they need to survive.

The tragedy is that the Finance officials are being aided and abetted by the passive acceptance of these innuendoes and allegations by leaders in the charitable sector. Finance's campaign has been greatly assisted by the vilification buzzword "loanback". A "loanback" is Finance's pejorative term for financing when an entrepreneur chooses to contribute to charity the earnings which a lender receives from borrowed money instead of adding them to the profits of Canada's powerful chartered banks. Finance's bias in favour of the big banks is made blatantly clear when one reads Resolution 21 to find that the only post-gift loanback exempted from the 50 per cent tax is when a financial institution holds the amount of the loanback on deposit. The fact is that most charities have never been involved in "loanbacks" and have no idea what this term actually means but are anxious to prevent them so as to protect the charitable sector from abuse. Consequently, they are unwitting dupes in Finance's campaign to deny donations of corporate wealth by calling into question the altruism of philanthropists who fund private foundations. It is much easier to criticize when the lender is a private foundation rather than a public charity. Canadian charities do not receive a huge amount from private foundations as there are so few of them in Canada. Finance officials are keen to cite the experience in the United States as inspiration for the Bre-X Provision. Charities who think that private foundations are irrelevant to their long-term financial health should note that private foundations alone gave Harvard

University $US 56,880,101 and the International Youth Foundation $US 28,650,000 in grants in 1994 and 1995.

Reality Checks

At the annual national conference of the Canadian Association of Gift Planners a plenary speaker exhorted charities, on ethical grounds, to stay away from charitable gifts which would involve loanbacks. He stated that it was unfortunate that some "dolphins" were caught in the net which the Finance officials had to cast to prevent these abuses for the good of the sector. The speaker would have Canadian charities focus their attention on funding sources such as charitable remainder trusts and publicly traded securities which are so important to charities in the United States.

Karl Marx's famous aphorism which states that "religion is the opiate of the masses" needs revision. It is time that someone in Canada proclaimed that the charitable remainder trust is the opiate of gift planners. In the 10 years since I wrote "Planned Giving Instruments: The Great Circle Route" [(1985), 5 *Philanthrop.* No. 2, pp. 3–24] advocating planned giving instruments, I have set up a total of five charitable remainder trusts. I know huge charitable institutions which have raised hundreds of millions of dollars in that same time period which have completed fewer than five charitable remainder trusts. It is time that Canadian gift planners awoke from their opiate-induced fantasies about charitable remainder trusts and conducted a reality check. If Finance officials have figured out where the real money available for charitable funding in Canada is, it is not too much to expect gift planners to do likewise.

A second reality check would recognize that development officers and gift planners employed directly by charities are no longer the primary players in moving large blocks of capital into the charitable sector. If you took the five individuals in Vancouver who, last year, were the primary players in moving the largest number of dollars into the charitable sector, you would find only one of them would be a development officer. Tax advisors would outnumber development officers. The largest group of professionals, however, would be high-end sophisticated estate planners familiar with life insurance products. More members of the Canadian Association of Life Underwriters would have successfully completed seven- and eight-figure donations to charity last year than would members of the Canadian Association of Gift Planners. This is because these life underwriters can show the wealthy entrepreneurs not only how to make tax-efficient gifts of capital but also how to replace the wealth on the donor's death. This is the group of professionals who will be the most adversely affected by Resolution 21. The problem for the charitable sector is that these professionals are only beginning to mobilize the transfer of wealth

to the charitable sector. Further, the potential of this type of planning and its benefits to the community are only beginning to be understood even by life underwriters.

In public, the downside of Resolution 21 has been noted as the unfortunate fact that a few philanthropist dolphins will be caught in Finance's "tuna" net. However, if the truth were known about the significance of "tuna" to the sustainability of the charitable sector, Canadians would never support such an assault. Finance knows that if it is to implement Resolution 21 without paying any political price it must make Canadians believe that "tuna" are actually bottom-feeding "mudsharks". Consequently, a campaign has been launched by Finance officials to portray tuna publicly as mudsharks. It is important to look at some real life examples so Canadians can determine if Finance's measures are at all appropriate.

Buyback Tuna

The economic reality is that most wealthy entrepreneurs are not sitting on $1,000,000 of cash. If they are to make a large gift to charity it will almost certainly be an asset gift. The most common asset which is not actively employed in generating employment and income is the shares in the business corporation or holding company owned personally by the donor. Finance officials can take some comfort in the fact that these shares are frequently pledged to a chartered bank as collateral so are not available as the basis of a gift to charity. A bank, however, will often release a small percentage of shares for a $1,000,000 charitable donation as long as it is assured that the charity will not continue to be a minority shareholder which can interfere with the entrepreneur's ability to control all of the business and corporate decisions which must be made. That restriction is no impediment to the entrepreneur because the entrepreneur is even less willing than the bank to have a charity as a minority shareholder. If the donor did not think that there was a reasonable possibility of repurchasing or having the company redeem the shares donated, he would not have made the gift. While the charity is usually happy to receive a gift of shares, it is even happier to learn that it must immediately liquidate them as it has no desire to hold a minority interest in a private corporation.

If the entrepreneur has cash, the shares will be bought back. More frequently, if the corporation has cash, the shares are redeemed and cancelled and the charity receives $1,000,000. This is referred to as a "buyback". Revenue Canada impugns such transactions on the legal basis that there was not gift at law because there was an implied condition that the shares would not be retained by the charity. In addition to the legal challenges, there is the insinuation that these gifts are suspect because it is very difficult to assess the fair market value of a private company. Officials refuse to acknowledge the policy

argument that there is no better protection against wildly inflating the stated value of a share for donation purposes than having the donor buy back the shares for the stated value. Even if the valuation is inaccurate, a charity which can sell seven per cent of the shares of a company for $1,000,000 has undoubtedly received a gift of $1,000,000. The point of the exercise from the charity's perspective is to determine the value of the gift and not the value of the seven per cent interest. If the charity sold the shares to anyone other than the donor or a person related to the donor, the arm's length purchaser would demand a deep discount on the value of the shares because the third party would only own a minority interest. This is an objective market reason why any charity will first attempt to sell such an asset to the donor instead of an arm's length buyer.

Loanback Tuna

However, the reason most donors are giving an asset is that they do not have $1,000,000 in the bank and therefore cannot afford to pay cash for a $1,000,000 block of their own shares. Consequently, the repurchase is financed in whole or in part by a promissory note. If the promissory note is issued by a private foundation, the charitable sector is protected from abuse by an existing penalty tax under Section 189 which effectively requires the purchaser to pay the private foundation a prescribed interest rate or prime interest rate. Consequently, the donor is paying a fair interest rate on the debt obligation and the charity is receiving a regular cash flow. Finance is frustrated that the protections against potential abuse resulting from private foundations not paying a fair market return on debt or share obligation to a non-arm's-length donor contained in Section 189 mean that it has almost no chance of succeeding in a court challenge to stop loanbacks. Consequently, it has brought out Resolution 21 as a dragnet with a very closely woven mesh to catch all tuna going to any type of charity. Section 189 was designed to make certain that the tuna going to a private foundation were fat and healthy. Resolution 21 is designed to prevent *any* tuna from reaching *any* charity.

Finance officials are correct in claiming that Section 189 does not dictate the level of security which a charity receives in a loanback. In different scenarios, there are different levels of security which can be taken in support of the principal of the promissory note. Those wanting to deduct a particularly high rate of interest paid to a private foundation will be advised by their tax professionals that a higher interest rate is justified if the level of security or collateral is lower. Finance officials have seized loanbacks, particularly the security issue, and succeeded in obtaining support of portions of the charitable sector to proclaim, with a high degree of dudgeon, that such arrangements are unethical abuses. Further, the implication is that such donors are scoundrels

about to skip town and their corporations are all teetering on the edge of bankruptcy. While recent press announcements have indicated that even such corporate pillars as Eatons can have financial problems, there is no need to change Canadian law to protect Canadian charities from the philanthropy of the Eaton family in the many decades when there are no financial problems. Nor is there any indication that the Eaton Foundation has been victimized by the current financial trouble. As an ordinary Canadian citizen who has never met a member of the Eaton family but has benefited from their huge and continued commitment to charitable funding, I find Resolution 21 an egregious insult to all Canadian philanthropists who generously support charities in the tradition of the Eatons.

Shareholder Loan Tuna

There is a new breed of tuna which Finance officials are particularly intent on stamping out. These tuna are not well known to most charities but are successfully sought by financial planners and sophisticated life insurance experts. They are the Canadian entrepreneurs who each year earn taxable income in their corporations in excess of $200,000. The normal pattern is that $200,000 is left in the private corporation and tax is paid at the 23-per-cent level available to small businesses. Any additional taxable income is paid as a bonus to the entrepreneur shareholder who then pays tax on it personally and loans the amount remaining after tax back to the company as a shareholder loan. These entrepreneurs have been encouraged to donate their shareholder loans to charity for a donation tax credit. The corporation then pays interest on the loan so the charity gets an annual cash flow. Frequently a corporate owned life insurance policy is taken out on the life of the donor so that the corporation has a prepaid source of funding to repay the principal of the loan. This also provides security to the recipient charity as the life insurance policy is normally paid over a period of three years and the proceeds assigned to secure the promissory note.

The policy argument raised by Finance officials against this form of gifting is that the donor takes a personal tax receipt and the corporation is responsible for repaying the loan. Why this is offensive is incomprehensible because the donor paid the tax when the money was paid out of the corporation and it is a corporate obligation to repay the donor. There is no reason to suggest abuse if the donor makes a gift which requires the debt to be repaid to a charity rather than the shareholder. Nor is there any abuse if the debt of the shareholder loan or the buyback promissory note is secured by taking out a life insurance policy.

The policy argument made, is that the donor takes an immediate tax receipt for 100 per cent of the amount of the donation and the charity does not receive the

principal amount until the possibly much delayed date of the donor's death. It is acknowledged by Finance officials that the charity receives an annual income stream. What charities need to wake up to is that if this criticism of giving shareholder loans is translated into legislated tax policy, then Finance has set the groundwork for attacking all endowment funding.

If philanthropist Smith makes a gift of a shareholder loan with an annual interest rate to a charitable foundation and has a life insurance policy to secure repayment of the principal on death, it is fundamentally the same economic transaction as philanthropist Smith making a $1,000,000 cash gift to a community foundation with instructions to have it placed in an endowment fund. In both cases, the capital is not available for immediate expenditure by any charitable organization. In both cases the initial tax credit for the donation is exactly the same. The only difference is that the community foundation controls its rate of return by its own investment policy, whereas the loanback has a predetermined rate of return which may or may not be variable. That is a minor difference which will not always work in favour of the community foundation. The probability that the community foundation will buy Bre-X shares and lose its capital is about the the same as the probability of the entrepreneur's company failing. It should be remembered that that company normally represents 85 per cent of the entrepreneur's wealth and the entrepreneur will thus do everything possible to keep it from failing.

There are too many varieties of tuna to be described here. Suffice it to say that tuna represent the best and most effective from of large block funding for the charitable sector in Canada in the foreseeable future. This wealth is in the hands of the entrepreneurs who realize that they "can't take it with them". Resolution 21 is not the product of dumb bureaucrats who do not know anything about the charitable sector. Resolution 21 is the product of economists who have better data on how the recent increase of seven- and eight-figure charitable donations is being structured and are seeking to protect the nation from truly significant charitable gifts. Unfortunately, they have the data and future projections to move to block this funding prior to the charitable sector fully understanding its significance. They also have the publicity machine to provide the negative spin doctoring which seeks to overcome the lack of hard policy or to provide specific public examples of abuse.

Mudsharks

It is important to examine one actual example of a "mudshark" from which the charitable sector has been protected since the Bre-X Budget. I have a client who, in 1993, made a donation of real estate to his private foundation and immediately thereafter sold it so that the private foundation realized a capital

gain of $10,000,000. The donor, which is a corporation, elected to make the gift at the corporation's adjusted cost base on the property, so it took no tax deduction for any of the capital gains. All of the capital gain was realized in the hands of the private foundation and it paid no tax on it. The real estate was immediately sold to a third party with payment in cash and there has been no allegation as to an abuse with regard to valuation. The corporation relied on Subsection 110.1(3) as statutory authority for claiming that the capital gain was not realized in its hands but was realized in the hands of the charity. Neither the private foundation nor the donor had any expertise in investing in the stock market. If the private foundation invested in guaranteed investment certificates and term deposits, it would receive about three percentage points less than the donor corporation was paying on money it was borrowing from the bank. Consequently, the donor borrowed the money back at an interest rate over prime with interest payments paid in cash every six months. Subsequently, the majority of the loan was secured by a real property mortgage.

Revenue Canada did not like the fact that it did not collect tax on the $10,000,000 capital gain and therefore set out to tax the corporate donor. The tone of the attack on the donor was set by having the donor for the first time in his life experience an audit by the tax avoidance people within Revenue Canada. The auditor told me in the most grave and intimidating way that this gift was being scrutinized by the committee in Ottawa which implements the General Anti-Avoidance Rule (GAAR). The auditor was sent to review my files relating to the incorporation and registration of the private foundation several years earlier on the basis that setting up the foundation was the first "step" in a series of "step transactions" culminating in the gift to which they were going to apply the GAAR. The gift in question had never been contemplated when the foundation was first set up as the donor's goal then was to endow the foundation with $1,000,000. At the time of the GAAR investigation, the donor's goal was to have $1,000,000 paid out of the foundation every year to be spent directly by operating charities.

This particular "mudshark" had no personal or corporate record of tax avoidance, evasions, or problems. His private foundation had a significant disbursement excess because each year it gave away much more money than the 4.5 per cent minimum payout requirement. The donor and his family did not abuse the foundation by taking salaries or charging rent and there were no such allegations. The only issue was the nonpayment of tax on the original gift and the loanback of the money by the private foundation with the consequent deduction for the interest expense paid by the donor.

It is very important for the charitable sector to understand that Revenue Canada has almost zero chance of succeeding in attacking the interest deduc-

tion resulting from this loanback under the GAAR rule as the borrower is actually paying the interest. Consequently there are no grounds for alleging it is a phantom cost giving rise to a tax benefit. It is instructive to know that in a 13-page single-spaced letter to this mudshark, the tax avoidance people never once used the term "loanback". It is even more instructive of the legal realities that the tax avoidance letter is completely silent on anything to do with the loanback part of the transaction and makes no allegation that it was an abuse. The letter only alleges that the original gift was "an avoidance transaction within the meaning of Subsection 245(3) of the Act, since the purpose of the transfer was to shelter the capital gain that would otherwise have arisen on the sale of the property. It is our opinion that this resulted in a misuse of Section 110.1(3) and abuse of the Act as read as a whole".

In the meetings leading up to the final letter from the tax avoidance officials and the reassessment of the donor corporation, I was told that Revenue Canada was proceeding under GAAR because they could find no technical flaw in the legal documents. In the final letter they raised some "bogus" technical legal point as to whether the corporation had the capacity to gift the property but they raised no tax issues. Two days before the Bre-X Budget, Revenue Canada issued a reassessment of the corporate donor's income tax returns for the years since 1993. This caused the donor to subsequently issue a cheque for more than $5,000,000 to pay for the income taxes on the capital gain and disallowed interest deductions as well as an installment penalty, installment interest, refund interest and arrears interest. There was an item of $522.57 for "Other" which was the total sum of reassessment related to the corporation's tax filings over a three-year period other than from the gift deduction and interest deduction.

This may sound like terribly bad news to the donor, but in reality it is good news for the donor from a financial perspective. Revenue Canada's only concern is collecting tax by denying that there was a charitable gift through this "misuse and abuse" of the *Act*. Revenue Canada does not have the slightest concern about protecting the interests of the charitable foundation. In personal meetings with Revenue Canada Charities Division, I have been assured that Charities Division is taking the position that not one penny of the impugned transaction was a gift to the private foundation and not one penny of the interest paid to the private foundation during the period of the loanback belonged to the private foundation. Further, I was assured I would have every co- operation in having the private foundation refile its T3010s for the years in question under the GAAR provisions in Subsection 2545(6) to make them consistent with the determination that no gift had been made to the charity. It was profoundly disillusioning to me to see that the Charities Division, which extols the rhetoric of a private foundation necessarily being independent from

the donor when the donor is attempting to take funds inappropriately from the private foundation, abandons that position completely when another branch of Revenue Canada is arguing that the private foundation has no effective separate independent existence from the donor so that Revenue Canada can set aside all of the donations made to it which produce a tax efficiency for the donor which Revenue Canada believes is too great.

While Revenue Canada Charities Division will not lift a finger to help the private foundation retain this $10,000,000, the donor will probably go to court to seek a declaration that a gift was indeed made. The reason the donor is doing this is because he has been made to feel like a mudshark by Revenue Canada's tax avoidance officials. From the donor's financial perspective, the corporation is much richer with the gift denied even after the payment of the tax. It would cost the national treasury far more if the donor made a subsequent gift of a comparable amount because under the 1997 Budget rules the donor would pay no tax on recapture (it was paid in 1993) as well as retaining a net charitable donation tax receipt for $2,500,000 representing the tax-free portion of the capital gain resulting from the gift (which the corporation did not take or claim in 1993). Further, the donor corporation would have a capital dividend account of $2,500,000 which, in British Columbia, is worth $900,000 after tax to the shareholders. One can only assume that the people in Ottawa persecuting this mudshark hope that he will be so disillusioned he will never make another comparable gift so that the national tax gatherers will not suffer the substantially greater losses of a comparable gift taking place under the 1997 rules which have a 75-per-cent deduction limit.

There can be no doubt that, in spite of the hype of the Bre-X Budget with regard to gifting publicly traded shares, there are very powerful forces at work in Ottawa trying to limit large-scale charitable funding. It is sad that most operational charities have no exposure to concrete examples such as the mudshark described above. To paraphrase Revenue Canada's tax-avoidance letter, I would allege that "invoking Subsection 245(3) was an avoidance transaction with the purpose of denying the donor the statutory right given by Subsection 110.1(3) to transfer the capital gain arising from the sale of the property to a registered charity. It is my opinion that this resulted in a misuse of Section 245 and abuse of the *Act* as read as a whole".

It is sobering to realize that if this mudshark had simply donated the real estate and the foundation had not immediately sold it, the gift would not have been attacked. However, the real estate market has fallen since 1993 in that particular community and is worth substantially less today than it was a the time of the gift. Further, the private foundation thought that Revenue Canada would be happy that it disposed of the real estate so that it was not subject to the

criticism that is was "carrying on the business" of managing a significant real estate portfolio.

What is even more infuriating is that the donor would have been completely immune from the criticism that he had benefited from a loanback and the scrutiny of the tax avoidance people if he had been chosen to provide a $300,000 annual subsidy to, for example, the Royal Bank of Canada. There would have absolutely no criticism of this transaction if the private foundation had placed the $10,000,000 in a term deposit earning five per cent at the Royal Bank and the donor corporation had borrowed $10,000,000 at eight per cent and had then deducted the interest payment. The security arrangements on the loan were not materially different. However, because the donor wanted the $300,000 annual interest spread to go to charity rather than to the Royal (or some other) Bank of Canada, he has been castigated as a mudshark engaged in an abusive loanback scheme and Revenue Canada has wrongfully denied a private foundation a $10,000,000 gift. It is impossible to understand why Finance officials are so opposed to having entrepreneurs borrow money at market rates from charities and, instead, insist that all such borrowing costs be paid to banks.

Dolphins

It is important to remember how Resolution 21 catches the "dolphins". I was called by a dolphin client several weeks ago who wanted to make a cash gift of $4,000,000 to his private foundation. He sought my legal advice as to whether there were any problems with regard to Resolution 21. After asking the appropriate questions to determine that the private foundation had no offending debt obligations or shares, I told him that there was no problem with the gift as long as he made sure that in the next five years the foundation did not acquire any such shares or debt obligation. What I forgot was that if the client, who is elderly, died within five years of the date of the gift then his will would give shares in related companies which would trigger a tax of $2,000,000. I phoned the donor with this caution the next working day, but the cash had already been transferred into the foundation. The donor was moving quickly because he had pledges to fulfil and intended to pay out the entire $4,000,000 to charitable organizations that week. Unfortunately, I had to advise him that if he died before changing his will, then the $2,000,000 tax would be triggered. Further, if the private foundation paid $4,000,000 out to other charities, it would no longer have the resources to pay this $2,000,000 tax. The donor's estate would have to pay the tax as Resolution 21 makes the donor jointly and severally liable with the charity for its payment.

The news got worse when I advised the donor that tax payments have to be made out of after-tax income. Consequently, the donor with his 54 per cent tax

rate would require $4,350,000 of additional taxable income to pay the tax resulting from having made a cash gift of $4,000,000 to charity. Needless to say, this particular dolphin is refusing to distribute the funds to needy charitable organizations until Resolution 21 is repealed or the necessary tax and estate planning can be done to avoid its consequences.

Conclusion

The Bre-X Budget casts a net for charities which catches dolphins, tuna and mudsharks. I know many individual philanthropists who fall into all three categories, but I have my greatest sympathy for mudsharks. They have taken the time, and committed the assets, to devote a significant portion of their estates to philanthropy on a planned basis. That is a far more complicated and demanding process requiring much more philanthropic commitment than simply being a dolphin and writing a cheque out of taxable income. Although the dolphins and the tuna may face the same financial penalties, they are not subjected to systematic and sustained innuendoes suggesting that they are the mudsharks responsible for all the grief experienced by the few dolphins whom, the politicians and bureaucrats are willing to admit, are inadvertently caught in the net of Resolution 21.

The Minister of Finance acknowledged in the House of Commons during Question Period on April 17, 1997 that the loanback provisions "may be too broadly drafted at present". He concluded by saying "I can assure the member that the government is consulting with, and will continue to consult, with the charitable sector to ensure that the legislation has neither adverse nor unintended consequences". It seems to me that there is no way that the intended consequences can be other than adverse to the potential for funding charities in Canada. Just as one does not know whether the problems in the Bre-X drill samples were known to the chief executive officer promoting the stock to the public, one cannot know the extent to which the Minister of Finance personally understands the extent of the problems created by the drafting of Resolution 21. Following the election, it is to be hoped the Minister will now have sufficient commitment to the charitable sector to develop a full understanding of the impact of Resolution 21 and not simply propose legislation to reduce the cost of charitable giving to the national treasury which the spin doctors and focus groups employed by Finance say can be flogged to the Canadian public by polling the drill results with a Bre-X Provision.