Tax Shelters -- No Shelter for Charities
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A few months ago, we discussed the basics of correctly issuing tax receipts for charities. Today, we will zero in on a key risk in this area, one where charities need to exhibit particular caution and prudence. That is the issue of entering into any of a number of schemes that are, or could be, considered to be tax shelters.

First off, cocktail party chatter aside, what exactly do we mean by a "tax shelter" and how might a charity find itself getting involved in such a thing?

According to Charity Tax Tools, Imagine Canada's new resource to make CRA reporting less "taxing" for charities, a tax shelter is "*any arrangement where the tax benefits equal or exceed the net cost of entering into the arrangement*". That is to say, from a taxpayer's perspective, a tax shelter is an arrangement that, initially at least, saves more in tax than it costs out of his or her pocket. Needless to say, any deal structured to achieve this goal is a pretty sweet deal for the taxpayer, although somebody has to pay to make such an arrangement work. And, unfortunately, the people left to pay in many such cases are you and me, in our capacities as the taxpayers who *don't* have access to fancy tax shelter schemes!

How do charities become involved in such arrangements? Well, typically, through tax receipting. It may be an arrangement where goods are donated to a charity (and possibly then repurchased from, or re-donated by, the charity), or where funds are donated, but as part of a complex series of transactions. The common factor in all these situations, however, is the charity finds itself writing significant tax receipts which, of course, give significant tax benefits, particularly to high-income taxpayers. The problem for the charity in all this is often,

- in determining a fair market value for gifts-in-kind (that is, non-cash gifts), in order to issue a receipt for that amount; or

- in generally being a party (however innocently) to a scheme that is ultimately going to offend the Canada Revenue Agency (CRA).

Indeed, CRA has put the sector (and tax shelter scheme promoters) on notice that it will aggressively investigate all apparent tax shelter schemes and pursue all parties to such schemes where it believes there has been a breach of the Income Tax Act.

And, CRA is backing up its words with action. It has been aggressively investigating such arrangements, and it has reassessed every taxpayer that it has determined to have taken part in one or more of these schemes. In fact, according to a tax alert issued by the CRA in late 2008, "over 65,000 taxpayers who participated in these schemes have been reassessed, or are in the process of being reassessed" ... in most cases, denying the gift completely. And, "well over $2.5 billion in claimed donations are being denied."

So, what of the charities that participated in these tax shelter schemes? There are a whole series of CRA news releases that tell this story, and every one of them starts with the title, "The Canada Revenue Agency revokes the charitable status of ...". It's not a pretty picture!

Now, we don't know the inside story on any of these schemes. It is possible that some involved charitable organizations that were actively, and knowingly, promoting illegal arrangements. But, it is also possible that some involved innocent charities that saw what they thought was a legitimate opportunity to address the severe funding challenges that so many in the sector are facing, and to help finance their good works. Everyone in the sector wants the former types prosecuted; nobody in the sector wants to be in the position of the latter.

So, how can good charities watch out for, and stay far away from, bad tax shelter schemes? To start, here are several "red flags" that should give pause and call for a serious investigation before proceeding:

- the arrangement is being proposed by a promoter that seems to already have everything in place -- all they are looking for is a charity, any charity, to plug into the deal

- "donors" seem to appear out of nowhere, with no, or only passing, interest in the work of the charity

- the overall arrangement seems to be extremely complicated, even if the charity's part in it is not

- the arrangement seems to require (and have) tax opinions from prestigious (and expensive!) law or accounting firms to justify or support it

- the arrangement includes goods that are notoriously hard to value, or that have dramatically different values in different contexts (think works of art, vaccines and medications, for example)

- there seem to be a whole lot more dollars ending up in promoters' and others' pockets than in your own (even if the dollars ending up in your pocket are beyond your wildest dreams!)

- the money is ultimately coming from a lender, rather than the donor, or it is not even clear where the money is coming from

- the cash your charity will eventual have on hand as a result of this scheme is a small percentage of the tax receipt value that you will have written

Now, we can't say that a scheme exhibiting any or all of these attributes is necessarily bad. In fact, sometimes a new, creative arrangement can be found that is entirely legitimate and beneficial. What we are saying, however, is that the bad schemes -- and they are out there -- will likely exhibit some of these characteristics, and you should be alert to the signals.

So, what to do if approached by a promoter with a deal that fits into the above category? Simply walk away without investigating? Well, that is risk avoidance in the extreme, and it may not serve your constituents' needs best. So, listen, for sure. Investigate. Understand who all the parties are in the arrangement, and make sure that they are reputable and have strong track records. Understand the "business deal" from all parties' perspectives, and ensure that the deal makes sense, apart from the tax benefits, for everyone. If there is no underlying economic rationale for the transaction you are looking at, except for tax write-offs, that's a sign of trouble.

Stand back, and ask what a reasonable observer would think about this deal. Whatever you do, don't turn a blind eye to the larger arrangement, looking solely at your own role in the deal. You can be sure that the CRA won't. And, you can be sure that the public won't either, when they hear about you in the news.

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All the above says no more and no less than the classic advice, "if a deal looks too good to be true, it probably is". There are no free lunches, and there is no easy money these days in the field of fundraising. Caveat emptor.