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## **GIFTING CULTURAL PROPERTY IN CANADA: TESTING A TAX EXPENDITURE**

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*The Canadian Income Tax Act provides a unique system of tax incentives to encourage the disposition of cultural property to public institutions by way of donation or sale. These tax incentives comprise a tax expenditure designed to indirectly support government policy objectives with respect to art and cultural property. This cultural property program is limited to gifts of particular property — “certified cultural property” — to “designated institutions.” The income tax incentives associated with disposition of cultural property are part of a larger statutory scheme under the Cultural Property Export and Import Act which controls the export out of and import into Canada of cultural property. At the centre of this statutory scheme is an administrative body, the Canadian Cultural Property Export Review Board, which plays a key role in fulfilling the objectives of the Cultural Property Export and Import Act and has a unique role in the administration of the income tax incentives pertaining to the disposition of cultural property; in particular in its responsibility for determining value for the purpose of issuing cultural property certificates under the Income Tax Act. Disputes over valuation of cultural property have been the focus of the debate amongst the stakeholders and in the Courts this is where this tax expenditure has been tested and recent decisions have determined its limits.*

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*La Loi de l'impôt sur le revenu en vigueur au Canada offre un système unique d'incitations fiscales pour encourager les contribuables à céder*

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*des biens culturels aux organismes publics par la voie de transactions de vente ou de donation. Ces incitations fiscales comportent, notamment, une déduction fiscale conçue pour appuyer indirectement les objectifs politiques du gouvernement en matière d'œuvres d'art et de biens culturels. Ce programme relatif aux biens culturels n'est applicable qu'aux donations de certains biens précis, les « biens culturels attestés » cédés à des « établissements désignés ». Les incitations fiscales qui encouragent la cession de biens culturels font partie d'un système législatif plus vaste, dérivé de la Loi sur l'importation et l'exportation de biens culturels qui régit l'exportation et l'importation de biens culturels au Canada. Au centre de ce système législatif, se trouve un organe administratif, la Commission canadienne d'examen des exportations de biens culturels. Cette dernière joue un rôle primordial dans la réalisation des objectifs de la Loi sur l'importation et l'exportation de biens culturels en ce qui concerne notamment l'administration des incitations fiscales dans le cadre de l'impôt sur le revenu en cas de cession de biens culturels, mais surtout en ce qui concerne la responsabilité d'évaluation dont la Commission est chargée dans le cadre de la délivrance de certificats fiscaux en vertu de la Loi de l'impôt sur le revenu. Les litiges portant sur l'évaluation de biens culturels font l'objet de nombreux débats entre les intéressés et devant les tribunaux où la validité des déductions fiscales a été mise à l'épreuve et leur portée a été circonscrite par la voie de décisions judiciaires récentes.*

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*“You know the trouble with museums?*

They're filled with so much stuff. Sure, the exhibits are interesting at first. But before long, we lose heart and get bored.

If only some of these intriguing items could speak. Tell us their story, and how they got there.

Well, today we're in luck. Through a remarkable (though technically inexplicable) process arranged by Pam Campbell of Sotheby's and curators Brian Musselwhite and Peter Kaellgren of the Royal Ontario Museum, we're about to chat with two stars of the ROM. ....

Now let's move over to the dinnerware area to have a word with the ROM's mazer bowl. Tell us, er, Mazer, what kind of bowl are you, anyway?"

“A rare one, dating back to the 1490s.” Mazers (Old English for “maple” bowls) were drinking vessels used by the upper classes for quaffing beer, wine and mead. “There are only 80 known in the world, and just three of my particular design. My life began around the time John Cabot discovered Newfoundland, and I passed through many

hands before I was purchased in England by a Canadian who kept me on a shelf in his Kingston, Ont., home for decades.”

“When he died, I was part of an estate auction. Because no one realized my true value, a dealer picked me up for peanuts.”

“Last year, just hours before I was to be auctioned at Sotheby’s in New York, the ROM invoked a federal law protecting Canada’s cultural heritage to block the sale. I was eventually purchased by the ROM for a rumored \$35,000 (U.S.) — a steal, [and the dealer got a decent tax break — not too bad eh!].”

“Hurrah! Another precious piece of ‘Canadiana’ saved from the Yanks.”<sup>1</sup>

### 1. Introduction

The ROM’s mazer;<sup>2</sup> Mel Lastman’s speeches;<sup>3</sup> drawings made by Madame de Pompadour’s art teacher;<sup>4</sup> old letters, photographs and other accumulated scraps belonging to Winnipeg artists Bill Lobchuk and Tony Tascona;<sup>5</sup> a disassembled prototype of a lighter-than-air, heavy-lift vehicle known as the Cyclo-Crane;<sup>6</sup> a diary kept by a Halifax housewife during the Second World War;<sup>7</sup> paintings by native artist Norval Morrisseau;<sup>8</sup> “Head,” a \$5,000 ceramic sculpture created by Quebec sculptor Louis Archambault;<sup>9</sup> the corporate archives of the Hudson’s Bay Company valued at \$49 million;<sup>10</sup> a collector’s Canadian proof bank notes and Byzantine coins;<sup>11</sup> 220 boxes of personal papers and assorted

<sup>1</sup> G. Gamester, “If Those Intriguing Museum Exhibits Could Only Talk” (12 August 1997) *Toronto Star* A4.

<sup>2</sup> *Ibid.*

<sup>3</sup> *Information Commissioner of Canada v. The Chairman of the CCPERB* (2001), 15 C.P.R. (4th) 74, (F.C.T.D.) [*Information Commissioner*].

<sup>4</sup> G. Quill, “AGO Grabs Prized French Artwork” *Toronto Star* (10 November 1998) A1.

<sup>5</sup> Canadian Press [CP], “Artists Enjoy an Unusual Tax Break” *Toronto Star* (25 March 1992) B7.

<sup>6</sup> *Aikman v. Canada*, [2000] 2 C.T.C. 2211 (T.C.C.) [*Aikman (TCC)*]; *Aikman v. Canada*, [2002] 2 C.T.C. 147 (F.C.A.) [*Aikman(FCA)*].

<sup>7</sup> Statement made by Sonia Lismer, Assistant Secretary to the Canadian Cultural Property Export Review Board, at a Panel Discussion on Canada’s Cultural Gift Program held at the Toronto International Art Fair, November 6, 2005.

<sup>8</sup> *Whent v. R.* (1996), 96 D.T.C. 1594 (T.C.C.) [*Whent (TCC)*]; *The Queen v. Whent*, [2000] 1 C.T.C. 329 (F.C.A.) at 340-41 [*Whent (FCA)*].

<sup>9</sup> *Maréchal v. Canada* (2004), D.T.C. 3227 (T.C.C.) [*Maréchal(TCC)*]; aff’d (2005), D.T.C. 5223 (F.C.A.) [*Maréchal (FCA)*].

<sup>10</sup> “Hudson’s Bay Gives Multi-Million Dollar Corporate Historical Records, Museum Collection To Manitoba” *Canada Newswire* (14 March 1994), online: <<http://www.newswire.ca/en/>>.

<sup>11</sup> *Conn v. MNR* (1986), 40 D.T.C. 1669 [*Conn*].

paraphernalia of Moses Znaimer, including City-TV T-shirts, books of matches from his trips to Japan and back issues of *Penthouse*, *Oui*, *Elite* and *Hustler* magazines;<sup>12</sup> and the photo collection of the Canadian National Railway Company<sup>13</sup> — all of these have been determined by the Canadian Cultural Property Export Review Board (CCPERB) to be of “outstanding significance” and “national importance” to the preservation of Canada’s heritage, and accordingly have yielded significant tax benefits to their owners upon donation to a variety of institutions and public authorities.<sup>14</sup> Indeed, depending on the course of my life, perhaps the manuscript for this paper could itself at some future time yield some tax benefit to a tax-wise owner.

The Canadian *Income Tax Act (ITA)*<sup>15</sup> provides a unique system of tax incentives to encourage the disposition of cultural property to public institutions by way of donation or sale.<sup>16</sup> While these incentives appear to be an extension of the existing rules for charitable giving, they must be considered independently of the tax programs which support charitable giving. Unlike the charitable donation programs, the cultural property program is limited to gifts of particular property — “certified cultural property” — to “designated institutions.” Foregone tax revenue through the provision of tax incentives is considered to be a tax expenditure. Rather than supporting program initiatives by direct subsidies, these same objectives are sought to be supported indirectly through income tax provisions which provide relief from tax in specific circumstances.

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<sup>12</sup> CP, “City-TV Founder Gets Much-Tax Break” *The [Waterloo] Record* (6 July 1998) A3.

<sup>13</sup> “Historic Canadian National Photographic Collection Donated To Canadians” *Canada Newswire* (10 May 2000), online: <<http://www.newswire.ca/en/>>.

<sup>14</sup> The above-mentioned donations were transferred as follows: the mazer to the Royal Ontario Museum; the Lastman archive to the City of Toronto; Mme. Pompadour’s art teacher’s drawings to the Art Gallery of Ontario; the letters and photographs of Winnipeg artists Lobchuk and Tascona to the University of Regina; the Cyclo-Crane to the Canadian Museum of Flight and Transportation in Langley, British Columbia; the diary of the anonymous housewife [unknown]; the Canadian bank notes and Byzantine coins to the University of Calgary Arts Museum; paintings of native artist Norval Morrisseau to a number of public galleries and museums; “Head” to the Montreal Museum of Fine Arts; the Hudson’s Bay Company corporate archive to the Provincial Archives of Manitoba; the Znaimer archive to the University of Toronto; the CNR photo collection to the Canada Science and Technology Museum in Ottawa.

<sup>15</sup> R.S.C. 1985 (5<sup>th</sup> Supp.), c.1 (*ITA*).

<sup>16</sup> *Ibid.*, ss. 39(1)(a)(i.1), 110.1(1)(c), the definition “total cultural gifts” in s. 118.1(1), s. 118.1(10) and s. 207.3.

The concept of tax expenditures, introduced by Professor Surrey,<sup>17</sup> allows for an analytic approach to the evaluation of incentive programs in terms of direct expenditures. This conceptual approach, introduced in Canada in the 1970s,<sup>18</sup> is now well established<sup>19</sup> and the Department of Finance publishes tax expenditure reports on an annual basis.<sup>20</sup> In the case of gifts of cultural property, recent improvements in methodology have allowed the government to attempt to provide more information in relation to the associated tax expenditure.<sup>21</sup> Unfortunately, accurate estimates are not available.

Whether Canada's cultural property tax incentives should indeed be properly characterized as tax expenditures may be open to debate. However, since the Canadian government treats them as such, the use of this conceptual framework facilitates the examination of these specific instruments as the means to further the government's objectives in the area of arts and cultural policy.<sup>22</sup> Salem has suggested that once the decision was made to use tax incentives to support art and cultural property, the participants in the process have been left to focus on

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<sup>17</sup> S. Surrey, *Pathways to Tax Reform: The Concept of Tax Expenditures* (Cambridge: Harvard University Press, 1973); S. Surrey and P. McDaniel, *Tax Expenditures* (Cambridge: Harvard University Press, 1985); S. Surrey, "Federal Income Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Governmental Assistance" (1970-71) 84 *Harv. L. Rev.* 352 at 360: "[E]merging emphasis on tax expenditures opens both a new way of examining tax incentives and special tax provisions and a new facet in the consideration of tax reform. Since tax incentives could have been and can be structured as direct expenditures, existing and proposed incentives can be tested in direct expenditure terms. So tested, many tax incentives will be seen as either inequitable, often to the point of being so grossly unfair as to be ludicrous, or ineffective."

<sup>18</sup> R. Smith, *Tax Expenditures: An Examination of Tax Incentives and Tax Preferences in the Canadian Federal Income Tax System* (Toronto: Canadian Tax Foundation, 1979).

<sup>19</sup> For an explanation of the differences between tax expenditures and tax concessions, see Department of Finance, "What is a Tax Expenditure?", online: <<http://www.fin.gc.ca/toce/1999/taxexpe.html>>.

<sup>20</sup> *Ibid.*

<sup>21</sup> See "Table 1," *ibid.* at 15. A. Salem, in *Private Choices and Public Funding: Financing Cultural Property Transactions Through Tax Expenditures* (LL.M. Thesis, York University, 1999) at 53, noted some of the difficulties of identifying the tax expenditure associated with cultural gifts: "The identification of tax expenditure can facilitate evaluation of public policy, and it should lead to an accounting in respect of the funds which the government has chosen not to collect. Unfortunately, in many cases, there are barriers which prevent comprehensive evaluation. For example, in the case of cultural gifts, the revenue forgone through the capital gains exemptions cannot accurately be measured."

<sup>22</sup> Salem, *ibid.* at 24.

technical issues, what he refers to as “quantity rather than quality.” There is a public perception that the tax incentives encourage the gifting of cultural property.<sup>23</sup> If this is the case, the proponents of the tax expenditure, in order to increase the tax benefits and encourage cultural property donation, should support strong incentives, while the federal government should attempt to constrain the cost of this expenditure by limiting its availability.<sup>24</sup> Unfortunately, reliable quantitative data in relation to the cultural property tax incentive program has not been available until very recently. CCPERB takes the position that its certification files are taxpayer information and not available to the public.<sup>25</sup> The CCPERB has very recently released the first cumulative report covering its activities for the period from April 1, 1992 to March 31, 2004, and a similarly detailed annual report for the period from April 1, 2004 to March 31, 2005.<sup>26</sup> This long-overdue report reviewing CCPERB activities was nearing completion for tabling in the House of Commons prior to the end of 2005, but the completion of that report was delayed until the recall of Parliament following the most recent federal elections and was unavailable for consideration when this paper was first written.<sup>27</sup>

One approach given the limitation of comprehensive information from those sources (at least until very recently) is to evaluate the cultural property tax incentive program by examining the response to the use of the system by its participants. Since the values ascribed to gifted cultural property will determine the extent of the tax benefit, it is not surprising to find that the disputes between the donor/taxpayers, institutions and government focus on the valuation of the gifted cultural property. It is here that the limits of the cultural gift program are tested. A review of case law in relation to the cultural property gifting program is proposed as one approach to considering the efficacy of this income tax incentive program.

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<sup>23</sup> Rob Faulkner, “Appraisers Place \$75M to \$90M Value on Tanenbaum Art” *The Hamilton Spectator* (13 February 2003) A1.

<sup>24</sup> Salem, *supra* note 21 at 54-55.

<sup>25</sup> *Information Commissioner*, *supra* note 3 at para. 10.

<sup>26</sup> Department of Canadian Heritage, *Cumulative Report 1992-1993 to 2003-2004: Cultural Property Export and Import Act* (Ottawa: Department of Public Works and Government Services, 2005), online: <[http://www.canadianheritage.gc.ca/progs/mcp-bcm/pubs/cumulative\\_report\\_03-04/Volume\\_2e1.pdf](http://www.canadianheritage.gc.ca/progs/mcp-bcm/pubs/cumulative_report_03-04/Volume_2e1.pdf)> [*Cumulative Report*]; Department of Canadian Heritage, *Annual Report 2004-2005: Cultural Property Export and Import Act* (Ottawa: Department of Public Works and Government Services, 2005), online: <[http://www.canadianheritage.gc.ca/progs/mcp-bcm/pubs/cumulative\\_report\\_03-04/AnnualReport\\_e.pdf](http://www.canadianheritage.gc.ca/progs/mcp-bcm/pubs/cumulative_report_03-04/AnnualReport_e.pdf)> [*Annual Report*].

<sup>27</sup> Telephone discussion with Manager, Movable Cultural Property Directorate/ Assistant Secretary to the Canadian Cultural Property Review Board, November 10, 2005.

It is important at the outset to appreciate that Canada's tax incentive program relating to the gifting of cultural property falls within a larger government mandate relating to cultural property. The income tax incentives associated with gifts of cultural property were introduced together with changes to the laws governing the export out of and import into Canada of cultural property. In the years following the Second World War, probably in response to the looting of cultural property by the Nazi regime on a historically unprecedented scale, the international community displayed an interest in taking steps to preserve cultural property. This resulted in a number of international initiatives.<sup>28</sup>

A comprehensive treaty, the 1970 *UNESCO Convention on the Means of Prohibiting and Preventing the Illicit Import, Export and Transfer of Ownership of Cultural Property* (UNESCO Convention), which was the first multi-national agreement of its kind, was adopted as a means of alleviating abuses in the international trade of cultural property and of preserving the heritage of the countries of origin.<sup>29</sup> As of October, 2003, 102 countries had ratified the UNESCO Convention.<sup>30</sup> Articles 6 and 7 of the Convention anticipate the use of national legislation to regulate the import and export of cultural property.<sup>31</sup>

Canada implemented the UNESCO Convention in 1977 by enacting the *Cultural Property Export and Import Act (CPEIA)*.<sup>32</sup> While the legislation was introduced both to preserve Canadian national heritage and to protect the legitimate interests of foreign states in the preservation of their cultural property heritage, a third main purpose of the legislation was the creation of new tax incentives to offset the negative impact that might result from the introduction of export controls on cultural property.<sup>33</sup> Accordingly, the *CPEIA* has a dual function. It regulates the import and export of cultural property and creates offences for illegal trafficking in cultural property and, together with the *ITA*, also provides tax incentives to encourage the donation or sale of significant examples

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<sup>28</sup> *Convention for the Protection of Cultural Property in the Event of Armed Conflict* (The Hague, 14 May 1954) 249 U.N.T.S. 240; and its accompanying protocol, *Second Protocol to the Hague Convention of 1954 for the Protection of Cultural Property in the Event of Armed Conflict* (The Hague, 26 March 1999).

<sup>29</sup> See art. 2 of *Convention On the Means of Prohibiting and Preventing the Illicit Import, Export and Transfer of Ownership of Cultural Property* (14 November 1970) 823 U.N.T.S. 231, reprinted in 10 I.L.M. 289 (1971).

<sup>30</sup> Online: <[http://www.unesco.org/culture/laws/1970/html\\_eng/page3.shtml](http://www.unesco.org/culture/laws/1970/html_eng/page3.shtml)>.

<sup>31</sup> *Supra* note 29, art. 6-7.

<sup>32</sup> R.S.C. 1985, c. C-51.

<sup>33</sup> Salem, *supra* note 21 at 33.

of Canadian cultural property to designated institutions and public authorities in Canada.

At the centre of this statutory scheme is an administrative body, the CCPERB, which plays a key role in fulfilling the objectives of the *CPEIA* and has a unique role in the administration of the cultural property gifting income tax incentive system.

The three primary duties of the CCPERB, an arm's length agency of the Department of Canadian Heritage,<sup>34</sup> are set out in section 20 of the *CPEIA*:<sup>35</sup> to review applications for export permits;<sup>36</sup> to make determinations of fair cash offers to purchase cultural property threatened with export;<sup>37</sup> and to determine the fair market value of cultural property for the purposes of the *ITA* in response to requests related to income tax certification under section 32 of the *CPEIA*. The CCPERB spends most of its time dealing with the certification of cultural property for the purpose of issuing cultural property income tax certificates<sup>38</sup> to individual and corporate donors and vendors;<sup>39</sup> however, since the certification process is part of the larger statutory framework of the *CPEIA* regulating the importation of foreign cultural property and the export controls administered by the CCPERB, a brief consideration of this larger scheme and the role of the CCPERB in that connection is appropriate.

### *Import Control under the CPEIA*

Canada implemented its obligations under Article 7(b) of the UNESCO Convention “to prohibit the import of [stolen] cultural property, and to take appropriate steps to recover and return...such stolen cultural property...provided that the requesting state shall pay just compensation to an innocent purchaser” through section 37 of the *CPEIA*.

An action for recovery of foreign cultural property imported into Canada illegally may be instituted by the Canadian government upon the request of a foreign state with which the Canadian government has entered into a bilateral “cultural property agreement,” or where both

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<sup>34</sup> *CPEIA*, *supra* note 32, s. 18.

<sup>35</sup> *Ibid.*, s. 20.

<sup>36</sup> *Ibid.*, s. 29.

<sup>37</sup> *Ibid.*, s. 30.

<sup>38</sup> Canada Revenue Agency Form T871.

<sup>39</sup> Correspondence with Manager, Movable Cultural Property Directorate/Assistant Secretary, Canadian Cultural Property Export Review Board, December 1, 2005 [Correspondence].

countries are parties to an international agreement such as the UNESCO Convention.<sup>40</sup>

An order for recovery of designated property may include an order for compensation payable by the foreign state where it is determined that the person subject to this order was either a bona fide purchaser for value of the subject property, or had valid title to the property and no knowledge at the time of purchase, or title acquisition, that the property was illegally exported from the foreign state.<sup>41</sup>

The *CPEIA* provides that importation into Canada of cultural property illegally exported from a foreign state that is party to a cultural property agreement with Canada is illegal<sup>42</sup> and an offence.<sup>43</sup> Canada Border Service Agency (CBSA) officials receive ongoing training to support their role in enforcement.<sup>44</sup> Prosecution under the enforcement provisions respecting import control have not been frequent, though the provisions have been upheld and convictions sustained.

The *CCPERB Cumulative Report* notes that since the *CPEIA* came into force there have been thirteen actions by Canada over illegal imports. Between 1992 and 2004, five of these actions resulted in the return of cultural property to their countries of origin, being Peru, Egypt, Columbia, Mexico, and Syria.<sup>45</sup>

In *R. v. Yorke*<sup>46</sup> the accused was charged with unlawfully importing foreign cultural property that had been illegally exported from Bolivia, contrary to section 43 of the *CPEIA*. The accused had spent approximately nine years in South America, mostly in Bolivia, where he had collected textiles and weavings of the Indigenous people of Bolivia. These textiles were shipped to Canada and offered for sale by the accused to various museums and collectors in Canada and the United States.

In dismissing the appeal of the accused from his conviction, the Nova Scotia Court of Appeal rejected the argument under section 7 of the *Charter* that the provision was too vague, and held that the provisions of

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<sup>40</sup> *CPEIA*, *supra* note 32, s. 37(1), (2) and (3).

<sup>41</sup> *Ibid.*, s. 37(5), (6).

<sup>42</sup> *Ibid.*, s. 37(2).

<sup>43</sup> *Ibid.*, ss. 43 and 44.

<sup>44</sup> CP, "Customs Officials Being Trained To Spot Looted Antiquities From Iraq" (8 May 2003).

<sup>45</sup> *Supra* note 26 at 16.

<sup>46</sup> (1998), 122 C.C.C. (3d) 298 (N.S.C.A.); leave to appeal refused [1998] S.C.C.A. No. 97.

the *CPEIA* under which the accused was convicted set clear limits to the prohibited conduct and are certain and unambiguous.<sup>47</sup> The Court took the view that the scheme of the Act concerns itself with the export and import of cultural property and, as with other regulatory offences, there is a duty on the importer to be familiar with the rules governing the regulated activity; the *CPEIA* does not incorporate foreign laws by reference.<sup>48</sup>

The accused also contended that the Bolivian Decree defining cultural property failed to specifically designate cultural property in that it did not set out a clear and unambiguous delineation of a threshold age for a weaving to be declared cultural property, and that it employed descriptions that were too broad and therefore did not sufficiently conform to the UNESCO Convention, or s. 37(1) of the *CPEIA*. The Court of Appeal held that whether the artifacts seized from the accused were the foreign cultural property of Bolivia was one of the elements of the offence to be proved by the Crown at trial and, accordingly, foreign law must be proved as a fact by the testimony of an expert in the law of the foreign state. The Court held that the Bolivian Decree in question clearly created three categories of cultural property and the items seized from the accused fell under them.<sup>49</sup>

### *Export Control under the CPEIA*

The CCPERB regulates the export from Canada of culturally significant objects of national importance deemed important to the preservation of national heritage. Under the *CPEIA*, property within a category included in the prescribed Canadian Cultural Property Export Control List<sup>50</sup> can only be exported with an export permit whether for sale or as a gift. The kinds of property subject to export controls are circumscribed by type,<sup>51</sup> age<sup>52</sup> and value,<sup>53</sup> or a combination of these factors.<sup>54</sup>

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<sup>47</sup> *Ibid.* at para. 63.

<sup>48</sup> *Ibid.* at para. 47.

<sup>49</sup> *Ibid.* at para. 77.

<sup>50</sup> Canadian Cultural Property Export Control List, C.R.C., c. 448 [Control List].

<sup>51</sup> *CPEIA*, *supra* note 32, s. 4(2).

<sup>52</sup> *Ibid.*, s. 4(3): “No object shall be included in the Control List if that object is less than fifty years old or was made by a natural person who is still living”.

<sup>53</sup> *Ibid.*, s. 4(2).

<sup>54</sup> *Ibid.*, s. 4(2)(c). In the period April 1, 2004 to March 31, 2005, 465 export applications were submitted for a determination as to whether an export permit should issue. 124 were for temporary export permits and 341 were for permanent export permits; see *Cumulative Report*, *supra* note 26; see also “Appendix 2-1,” *Annual Report*, *supra* note 26 at 81.

Applications for export are examined by permit officers designated by the CBSA to determine if an export permit should issue immediately for certain specific objects<sup>55</sup> and for other objects which are not named on the Control List.<sup>56</sup> Where a permit officer is in doubt about whether the object is included on the Control List, the application is referred to an expert examiner;<sup>57</sup> in the case where the expert examiner determines the object to be included on the Control List, a further determination is made as to (a) whether that 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 (b) whether the object is of such a degree of national importance that its loss would significantly diminish Canada's national heritage.<sup>58</sup> If the object meets these criteria, the permit officer is advised not to issue an export permit and a notice of refusal is issued to the applicant.<sup>59</sup> Otherwise the expert examiner advises the permit officer to issue an export permit.<sup>60</sup>

The decision not to issue an export permit may be reviewed by the CCPERB, which may direct the issuance of an export permit if it finds that the object either is not on the Control List or does not meet the necessary criteria of "outstanding significance" and "national importance."<sup>61</sup> Where the CCPERB is of the opinion that a "fair offer to purchase" the object in question might be made by a Canadian institution or public authority within six months, the Board will refuse an export permit and establish a delay period of two to six months. During this time, no export permit may be issued in respect of the object.<sup>62</sup> If it does not appear that a fair offer to purchase will be made, then an export permit will be issued immediately.<sup>63</sup>

When a delay period is established, the Minister of Canadian Heritage is obliged to notify those institutions and public authorities considered appropriate, in order to allow them to make a fair offer of purchase.<sup>64</sup> If an offer is made but not accepted by the owner, then either party, offeror or offeree, may request that the CCPERB determine the

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<sup>55</sup> *CPEIA*, *supra* note 32, s. 7.

<sup>56</sup> *Ibid.*, s. 8.

<sup>57</sup> *Ibid.*, s. 6(1). The Minister may designate any resident of Canada or any institution in Canada as an expert examiner for the purposes of this Act. Expert examiners include more than 350 academics, curators, archivists, librarians and others.

<sup>58</sup> *Ibid.*, ss. 9, 11.

<sup>59</sup> *Ibid.*, ss. 11, 13.

<sup>60</sup> *Ibid.*, s. 12.

<sup>61</sup> *Ibid.*, s. 29.

<sup>62</sup> *Ibid.*, s. 29(5)(a).

<sup>63</sup> *Ibid.*, s. 29(5)(b).

<sup>64</sup> *Ibid.*, s. 29(7).

amount of “a fair cash offer to purchase.”<sup>65</sup> No export permit will be forthcoming if an owner refuses an offer from an institution or public authority that is equal to or greater than the amount of a fair cash offer as determined by the Board.<sup>66</sup>

If no offer is forthcoming, the CCPERB will direct the issue of an export permit.<sup>67</sup> Indeed, some culturally significant works do end up leaving the country when there is no institutional interest in acquiring the work.<sup>68</sup>

Between 2004 and 2005, 29 export permit applications were reviewed by the CCPERB. Twenty-eight were denied.<sup>69</sup> Of these, eight applications resulted in permits being issued at the end of the delay period, five applications resulted in institutional purchase during the delay period, and 17 applicants made no request for issue of a permit following the end of the delay period.<sup>70</sup>

In order to support purchases by designated institutions where an export permit has been refused and a delay period imposed, cultural property grants and loans under the Movable Cultural Property Program may be awarded to applicable institutions or public authorities in Canada.<sup>71</sup> Grant applications are first considered by the CCPERB, which then recommends to the Minister of Canadian Heritage that the grant be approved.<sup>72</sup> These funds are also available for patriation<sup>73</sup> or repatriation<sup>74</sup> of cultural objects associated with Canadian heritage which have become available on the international market.<sup>75</sup>

By way of example, these funds were accessed and matched by the Royal Ontario Museum (ROM) in its purchase of a rare mazer bowl whose owner's application for an export permit was refused by the CCPERB; initially the bowl had been placed on the international auction

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<sup>65</sup> *Ibid.*, s. 30(1).

<sup>66</sup> *Ibid.*, s. 30(5).

<sup>67</sup> *Ibid.*, s. 30(5).

<sup>68</sup> “Canadian Treasure Southbound” *The Ottawa Sun* (27 June 2003).

<sup>69</sup> “Appendix 1 – 12,” *Annual Report*, *supra* note 26 at 78.

<sup>70</sup> “Appendix 1 – 13,” in *ibid.* at 79-80.

<sup>71</sup> Quill, *supra* note 4.

<sup>72</sup> *CPEIA*, *supra* note 32, s. 35.

<sup>73</sup> J. Stoffman, “Bard’s Image Likely to Stay in Canada” *Toronto Star* (12 May 2001) A26.

<sup>74</sup> CP, “National Archives Acquires Historic Watercolors” *The Hamilton Spectator* (23 March 1996) 19.

<sup>75</sup> Cultural Property Grants and Loans, online: <[http://www.pch.gc.ca/progs/mcp-bcm/grants\\_e.cfm](http://www.pch.gc.ca/progs/mcp-bcm/grants_e.cfm)>.

market without the applicable export permit, and once the auction house was alerted, the object was withdrawn from auction, returned to Canada, and the owner's application for an export permit was refused.<sup>76</sup>

In the period 2004 to 2005 fifteen Movable Cultural Property grants were awarded for a total of \$177,330.<sup>77</sup>

The *Cumulative Report* notes that in the period between April 1, 1992 and March 31, 2004, 161 applications for export permits that had been refused by a permit officer on the advice of an expert examiner were reviewed by the Board. 27% of these applications pertained to objects of fine art, 37% to objects of ethnography and ethnographic art, 15% to objects of decorative art and the remaining 21% to objects of archaeology, paleontology, mineralogy, military medals, photographs, heritage vehicles and archives. 86% of all the applications reviewed by the CCPERB were denied. Of these, 40% of the objects remained in Canada as a result of purchase with grant support, and 45% were exported at the end of the delay period. The remaining objects for which export permits were denied stayed in Canada either because the object was sold in Canada without grant support, or because the delay period expired and no request was made by the applicant for the issue of a permit.<sup>78</sup>

The *CPEIA* also creates certain offences in relation to its export control provisions. These include: exporting or attempting to export, without a permit, an object included on the Control List; unlawful transfer of a permit;<sup>79</sup> and providing false information in relation to an application for a permit<sup>80</sup> or for the purpose of procuring a permit or in connection with the use of a permit.<sup>81</sup> These are considered to be strict liability offenses.<sup>82</sup>

*R. v. Groulx*, a recent decision of the Quebec Superior Court, demonstrates the degree of care required to establish a due diligence defense.<sup>83</sup> Mr. Groulx was a self-described amateur paleontologist who had purchased fossil specimens during a fossil collection show in Ohio. He was accompanied by a world renowned fossil conservationist, and

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<sup>76</sup> P. Kaellgren, "A Rare Mazer Bowl Acquired by the ROM" (1998) 13:3 *Rotunda* at 5.

<sup>77</sup> "Appendix 2 – 4," *Annual Report*, *supra* note 26 at 82.

<sup>78</sup> *Cumulative Report*, *supra* note 26 at 11.

<sup>79</sup> *Supra* note 32, s. 40.

<sup>80</sup> *Ibid.*, s. 41.

<sup>81</sup> *Ibid.*, s. 42.

<sup>82</sup> *R. v. Groulx*, [2004] Q.J. No. 10532 (Sup.Ct.) [*Groulx*].

<sup>83</sup> *Ibid.*

had left the specimens with the conservationist so that work could be done on them to determine what fossils or fossil traces were present. Because the conservationist was overwhelmed with work and had only been able to prepare two specimens after about eighteen months, Mr. Groulx retrieved the specimens and brought them to Canada. He was exporting them to a second conservationist located in Utah when they were seized. On the commercial invoice he described the material as “geological specimens, nodules.” He stated the country of origin as “Ohio, U.S.A.” The 78 pounds of specimens which had been seized by the RCMP were determined by the Crown’s expert to be approximately 370,000,000 years old and to have originated from a world famous palaeontological site located in the Parc de Miguasha in the Gaspé region of Quebec. Mr. Groulx suspected that his specimens originated from the Miguasha site notwithstanding that he had purchased them in the United States.<sup>84</sup>

The Court found that Mr. Groulx, suspecting he had Canadian fossil specimens, knowing the purpose for which he was sending them outside the country and because of his amateur paleontology experience, was required to present them to a permit officer under the *CPEIA*. The Court found that his failure to do so, even though based on ignorance of the law, fell short of establishing due diligence. Accordingly, the Court allowed the Crown’s appeal, quashed the acquittal of the accused and substituted a guilty verdict.<sup>85</sup>

Since the *CPEIA* came into force there have been no reported cases of illegal importation of Canadian cultural property into other 1970 UNESCO Convention signatory states. However, a number of attempts to export cultural property illegally have been prevented by the CBSA. There have also been instances where cultural property that has left the country illegally has been returned from abroad.<sup>86</sup>

#### *Certification of Cultural Property under the CPEIA*

While the *CPEIA* regulates the export and import of cultural property and the CCPERB has a role in that regard, most of the CCPERB’s time and attention is taken up by its duties in relation to certification of cultural property for the purpose of those seeking to take advantage of the cultural property disposition tax incentives.<sup>87</sup> Indeed it is somewhat ironic that those provisions which were introduced as a secondary aspect

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<sup>84</sup> *Ibid.* at para. 40.

<sup>85</sup> *Ibid.* at para. 42.

<sup>86</sup> *CPEIA*, *supra* note 32, s. 11.

<sup>87</sup> Correspondence, *supra* note 39.

of this legislative scheme have evolved to such a prominent place in the program that they appear to have overshadowed the original purposes of the legislation and now dominate the agenda of the CCPERB. The *Cumulative Report* notes that in the twelve year period from 1992 to 2004, the CCPERB made determinations on an annual average of 1,085 applications for certification representing \$127 million in cultural property; donations to designated institutions comprised 97% and sales to designated institutions comprised 3% of this amount.<sup>88</sup>

The current role of the CCPERB in the certification process is set out in section 32 of the *CPEIA*. The income tax incentives for disposing of certified cultural property apply only when the disposition is to “an institution or public authority in Canada that was, at the time the gift was made, designated by the Minister of Heritage.”<sup>89</sup> No income tax certificate will issue if the donation is made to an institution prior to its designation.<sup>90</sup> There are two categories of designation: Category A Designation is granted for an indefinite period of time to institutions and public authorities that are well established and meet all the criteria for designation.<sup>91</sup> Category B Designation is granted exclusively in relation to the proposed acquisition of a specific object to institutions that do not meet all the criteria for designation but have demonstrated their capacity to preserve the specific cultural object for which certification is sought.<sup>92</sup>

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<sup>88</sup> *Supra* note 26 at 6; the report states that archival and library material constituted approximately 22% of all applications. The largest number, however, 72%, were fine art (paintings, works on paper, and sculpture), with a high proportion of the fine art - perhaps as much as 85% - consisting of Canadian contemporary art. Other dispositions included decorative art, ethnographic objects, folk art, and items as diverse as collections of insects, fossils, meteorites, militaria, minerals, antique automobiles, and vintage aircraft. Appendices 1-5 to 1-11 of the report list the certifications by various categories.

<sup>89</sup> *ITA*, *supra* note 15, ss. 39(1)(a)(i.1), 110.1(c), 118.1(1), (10) and 207.3; *CPEIA*, *supra* note 32, s. 32(2).

<sup>90</sup> *Williamson v. Canada (Attorney General)*, (2005) D.T.C. 5429 (F.C.T.D.). The Federal Court dismissed the donor’s application for the judicial review of the decision of Victoria Baker, A/Manager, Movable Cultural Property Program, Heritage Canada that the Fort Saskatchewan Historical Society was ineligible to be designated as a Category B institution. As the Applicant had already donated the property in issue to the Society and legal title had passed to the Society, Ms. Baker ruled that the Society was ineligible to be designated under s. 32(2) of the *CPEIA*, *supra* note 32. The policy of the Department of Heritage is that once a donation has been made and legal title has passed, the institution is no longer eligible to be designated and the donor is no longer eligible for the tax benefits for gifts of “certified cultural property” under the *ITA*, *supra* note 15.

<sup>91</sup> For a current list of Category A designated institutions, see Department of Canadian Heritage, *Movable Cultural Property Program*, online: <[http://www.pch.gc.ca/progs/mcp-bcm/design\\_e.cfm](http://www.pch.gc.ca/progs/mcp-bcm/design_e.cfm)>.

<sup>92</sup> *Supra* note 32, s. 32(2).

The object which is subject to disposition need not be on the Control List and, accordingly, the certification program encompasses a broader range of property than that subject to the export control provisions of the *CPEIA*.<sup>93</sup>

In order to receive a cultural property income tax certificate for disposing of cultural property to a designated institution or public authority, the donor or vendor must apply to the CCPERB for a determination as to whether the cultural object which is being disposed of meets the criteria of “outstanding significance” and “national importance” set out in subsection 29(3)(b) and subsection 29(3)(c); if the object meets these criteria, the CCPERB must determine the fair market value of the object.<sup>94</sup> Only when the object has been irrevocably disposed of to a designated institution or public authority will the CCPERB issue the applicable certificate for income tax purposes.<sup>95</sup>

In assessing whether the object to be disposed of meets the required section 29 criteria of “outstanding significance” and “national importance,” the CCPERB will take a recipient-based approach.<sup>96</sup> Moreover, the policy of the CCPERB in assessing these criteria is to recognize that regional differences exist across the country. Other factors considered by the CCPERB will include: pertinence; association with other objects; significance of the maker, author or collector; significance of the object; archival, documentary or research value; authenticity/attribution; aesthetic qualities; condition; rarity; number of copies; Canadian content; medium; and date of the works.<sup>97</sup>

In making determinations of fair market value the position of the CCPERB is that “it should reflect, not establish, the current market for the cultural property it certifies.”<sup>98</sup> The CCPERB has adopted the following definition of fair market value:

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<sup>93</sup> The Department of Canadian Heritage reports on its CCPERB website that 70% of applications made to the Board are for donations of works of art and 25% of applications made to the Board are for donations of archival material; online: <[http://www.canadianheritage.gc.ca/progs/cebc-cperb/index\\_e.cfm](http://www.canadianheritage.gc.ca/progs/cebc-cperb/index_e.cfm)>.

<sup>94</sup> *CPEIA*, *supra* note 32, s. 32(1).

<sup>95</sup> *Ibid.*, s. 32(1).

<sup>96</sup> “Making Applications for Certification of Cultural Property for Income Tax Purposes: Cultural Property Export and Import Act, Information and Procedures Booklet” revised October 1997, updated July 2002, online: <[http://www.pch.gc.ca/progs/cebc-cperb/leibc-cpeia/index\\_e.cfm](http://www.pch.gc.ca/progs/cebc-cperb/leibc-cpeia/index_e.cfm) at 12>.

<sup>97</sup> *Ibid.* at 16-19.

<sup>98</sup> *Ibid.* at 9.

The highest price, expressed in terms of money, 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.<sup>99</sup>

Certification applications must be accompanied by appraisals. The current policy of the CCPERB is that one appraisal is required when the total estimated fair market value of a donation is \$20,000 or less. Where the total estimated fair market value of a donation is above \$20,000, two appraisals are required unless the appraisal is provided by an appraisal committee which includes members of one of a number of recognized art or cultural property dealer associations. In cases of donations of audiovisual material where the total estimated fair market value is greater than \$500,000, three appraisals are required.<sup>100</sup>

Within the twelve months following notification of a determination of fair market value by the CCPERB, the person disposing of the property may request that the CCPERB redetermine the property's fair market value.<sup>101</sup> Additionally, the CCPERB may on its own initiative redetermine fair market value at any time.<sup>102</sup> In either case, it may do so with respect to both completed and proposed gifts. The power of the CCPERB to redetermine fair market value is circumscribed by the *CPEIA*, which provides that unless the circumstances of a particular case require otherwise, it shall not make more than one redetermination.<sup>103</sup>

Where the CCPERB has made a redetermination in respect of a proposed disposition, that redetermination is not subject to appeal, or review by any court.<sup>104</sup> When certifying cultural property, the Board may receive any information that it considers relevant, either orally or in writing. The CCPERB is bound by the rules of procedural fairness when making its decisions. It must make any information it receives available to the party who has applied for a determination under subsection 32(1) and must give the party an opportunity to make representations respecting that information.

Oral submissions and public hearings are contemplated by the *CPEIA*,<sup>105</sup> and there may be some cases where the requirements of

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<sup>99</sup> *Ibid.* at 24.

<sup>100</sup> Department of Canadian Heritage, *CCPERB Board Resolutions*, January 2005, online: <[http://www.pch.gc.ca/progs/cebc-cperb/board\\_e.cfm](http://www.pch.gc.ca/progs/cebc-cperb/board_e.cfm)>.

<sup>101</sup> *Supra* note 32, s. 32(5)(a).

<sup>102</sup> *Ibid.*, s. 32(5)(b).

<sup>103</sup> *Ibid.*, s. 32(8).

<sup>104</sup> *Ibid.*, s. 32(9).

<sup>105</sup> *Ibid.*, ss. 25, 26, 27, 28.

procedural fairness cannot be met without an oral hearing.<sup>106</sup> An appeal to the Tax Court of Canada is available following a redetermination by the CCPERB in the case of a disposition that has been irrevocably made and the Tax Court of Canada may confirm or vary the fair market value for income tax purposes.<sup>107</sup>

The cultural property income tax incentives were introduced together with the *CPEIA* in 1977.<sup>108</sup> The tax savings obtained for gifting certified cultural property under a cultural property income tax certificate are significantly greater than those for donations of property to the Crown or to registered charities for a charitable tax receipt.<sup>109</sup>

The requirements to obtain a credit or deduction for dispositions of certified cultural property are discussed more fully in *Interpretation Bulletin IT-407R4*.<sup>110</sup> If the CCPERB certifies the cultural property object and the object is donated to a designated institution or public authority, the donation is considered a cultural gift and the individual donor is entitled to a tax credit,<sup>111</sup> while a corporate donor may take a full deduction from income.<sup>112</sup> Tax relief is based on the fair market value of the property at the time of donation up to 100 per cent of the donor's income in the year.<sup>113</sup> For the purposes of the rules relating to the tax treatment of a disposition of cultural property that is certified by the CCPERB, the fair market value of an object is deemed to be the fair market value determined by the CCPERB.<sup>114</sup>

For applications for certification made after February 20, 1990, the CCPERB was delegated an official role with respect to taxation matters by making determinations of fair market value; prior to this, challenges to valuation were initially made by the taxation authorities through taxpayer assessment.<sup>115</sup> Unlike the other entities listed in Sections 110.1

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<sup>106</sup> *Art Gallery of Ontario v. Canada (Cultural Property Export Review Board)*, [1994] 3 F.C. 691 [*Art Gallery of Ontario*].

<sup>107</sup> *CPEIA*, *supra* note 32, ss. 33.1(1), (2).

<sup>108</sup> S.C. 1974-75-76, c.50, amending the *ITA*, *supra* note 15.

<sup>109</sup> Canada Revenue Agency, "Appendix A," *Income Tax Interpretation Bulletin IT-407R4 (Consolidated) Dispositions of Cultural Property to Designated Canadian Institutions*, <<http://www.cra-arc.gc.ca/E/pub/tp/it407r4-consolid/it407r4-consolid-e.html>>.

<sup>110</sup> *Ibid.*

<sup>111</sup> *ITA*, *supra* note 15, s. 118.1(1). Prior to the 1987 *ITA* amendments the individual donor was entitled to an income tax deduction for the donation.

<sup>112</sup> *Ibid.*, s. 110.1(c).

<sup>113</sup> *Ibid.*, ss. 110.1(c), 118.1(1).

<sup>114</sup> *Ibid.*, s. 118.1(10).

<sup>115</sup> *An Act to Amend the Income Tax Act et al*, S.C. 1991, c. 49, s. 218.

and 118.1 of the *ITA*, gifts of cultural property to designated institutions have never been subject to an annual limit with respect to the taxpayer's income.<sup>116</sup> Any unused income tax credits or deductions can be carried forward five years.

An important and unique feature of the cultural property tax incentive program is that, regardless of whether the property is gifted or sold to a designated institution or public authority, if the cultural property has been certified there will be no recognition of the capital gain.<sup>117</sup> A designated cultural institution that disposes of a certified cultural property within ten years<sup>118</sup> of the time the property was first certified by the CCPERB and disposed of in favour of a designated cultural institution will be subject to a special tax equal to 30 per cent of the fair market value of the property at the time of such disposition, unless the disposition is made to another designated cultural institution.<sup>119</sup>

Since these rules apply to capital property, special rules have been introduced for artists (though not galleries) to have their inventory certified as cultural property. If property from an artist's inventory is certified by the CCPERB, the artist can treat its value for disposition purposes as being its cost but can claim the full fair market value in computing his tax liability, using the same rules applicable to other donors of cultural property.<sup>120</sup> This aspect of Canada's program compares favorably with the tax treatment of cultural property gifts in the United States where, notwithstanding a broad exemption from capital gains tax available to donors, artists have not yet received equivalent treatment for donations of their own works.<sup>121</sup> In the Board's 2003-2004 year, the CCPERB made determinations with respect to 145 donations by artists of their work, representing 15 per cent of the total objects certified; this represented an aggregate certified value of approximately \$6.1 million.<sup>122</sup>

Since the amount of the tax benefit will be determined by the valuation placed on the cultural property to be certified, this is where the

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<sup>116</sup> *CPEIA*, *supra* note 32, s. 50; *ITA*, *supra* note 15, s. 118.1 (1).

<sup>117</sup> *ITA*, *ibid.*, s. 39(1)(a)(i.1).

<sup>118</sup> Five years, if the property was disposed of prior to February 24, 1998.

<sup>118</sup> *ITA*, *supra* note 15, s. 207.3.

<sup>120</sup> *Ibid.*, ss. 118.1(7), (7.1).

<sup>121</sup> R. Pogrebin "Senate Bill Lets Artists Claim Price For Gifts" *New York Times* (22 November 2005) E1: "Living writers, musicians, artists and scholars who donate their work to a museum or other charitable cause would earn a tax deduction based on full fair market value under a bill just passed by the Senate. Currently such work receives only a deduction based on the cost of materials."

<sup>122</sup> *Cumulative Report*, *supra* note 26 at 8.

limits of this tax expenditure are tested. Most of the recent decisions arising under the *CPEIA* deal with valuation questions pertaining to certified cultural property.

### *Valuation of Cultural Property*

For the purposes of the rules relating to the tax treatment of a gift of cultural property that is certified by the CCPERB, the fair market value of an object is deemed to be the fair market value determined by the CCPERB.<sup>123</sup> Additionally, the taxpayer may appeal to the Tax Court of Canada where property has been disposed of by a taxpayer to a designated cultural institution and its fair market value has been redetermined by the CCPERB.<sup>124</sup> Since the amount of benefit to the taxpayer-donor, the consequential subsidy to the institutions and the tax expenditure represented by the forgone revenue not collected by the government depend on the valuation of the object to be disposed of, it is not surprising that this has become the significant arena of engagement between government, taxpayers and other stakeholders in this program. Moreover, the valuation of donated art and cultural property raises some complex issues. The Tax Court of Canada noted as much in the most recent of its CCPERB appeal decisions:

Valuing a work of art is difficult. It is not like valuing a piece of commercial property, or a house, or shares in a corporation. Well-defined criteria for such valuations are more readily available. In valuing a work of art there are many variables and subjective elements that can result in differences in estimates of value that may vary within a range of indeterminate magnitude.<sup>125</sup>

These difficulties were recognized in the first case decided under the cultural gift tax incentives, *Conn v. M.N.R.*, a Tax Court of Canada decision concerning the value of a certified collection of proof and specimen Canadian bank notes.<sup>126</sup> The taxpayer's appraisal reports supported values of \$345,250 and \$351,400 for the notes; the appraisal report of the Minister of National Revenue supported a value of \$108,500. The Tax Court held that no premium was to be found in the character of the donation as a collection, because on the facts of this case

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<sup>123</sup> *ITA*, *supra* note 15, s. 118.1(10).

<sup>124</sup> *CPEIA*, *supra* note 32, ss. 33.1(1), (2).

<sup>125</sup> *Maréchal(TCC)*, *supra* note 9 at para 15.

<sup>126</sup> *Supra* note 11 at 1682, where Brulé T.C.J. noted: "It becomes most difficult to place a value on this donation because of the nature of the subject matter in the absence of significant comparables to establish fair market price. Certainly supply and demand have a bearing, and as to supply the factor of the rarity of the notes must be taken into consideration, tempered by the condition of the notes."

that element was not established.<sup>127</sup> Nor did the Tax Court attribute any significance to the donated notes in terms of their historic value.<sup>128</sup> Ultimately recognizing the difficult question of valuation pertaining to such property, in Solomonic fashion the Tax Court determined the value to be \$200,000, relying on the following statement of Walsh J. in *Bibby Estate v. The Queen*:

While it has frequently been held that a Court should not, after considering all the expert and other evidence merely adopt a figure somewhere between the figure sought by the contending parties, it has also been held that the Court may, when it does not find the evidence of any expert completely satisfying or conclusive, nor any comparable especially apt, form its own opinion of valuation, provided this is always based on the careful consideration of all the conflicting evidence. The figure so arrived at need not be that suggested by any expert or contended for by the parties.<sup>129</sup>

The tax planning possibilities of the certified cultural gift program were tested early on in *The Queen v. Friedberg*, a case which arose prior to the amendments to the *CPEIA* providing for fair market valuations of certified cultural property to be made by the CCPERB for income tax purposes.<sup>130</sup>

In *Friedberg* the Crown appealed to the Federal Court of Appeal a Tax Court of Canada decision in favour of the taxpayer concerning deductions claimed as a result of donations made to the ROM under the certified cultural property gift program.<sup>131</sup> The taxpayer claimed to have given two collections of ancient textiles to the ROM as gifts, both of which had been certified by the CCPERB. The taxpayer had arranged for the acquisition of these collections for the purpose of making these donations. The Tax Court held that the taxpayer had title to the collections and was legally in a position to donate them.

The appeal was allowed regarding one of the collections which the taxpayer did not own but which had been originally sold to the ROM and not to the taxpayer. The Federal Court of Appeal held that the Tax Court's conclusion regarding that collection was based on an error of law in that the judge failed to appreciate the importance of the "document purporting to pass title" to the ROM.<sup>132</sup>

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<sup>127</sup> *Ibid.* at 1674.

<sup>128</sup> *Ibid.* at 1675.

<sup>129</sup> (1983), 83 D.T.C. 5148 at 5157.

<sup>130</sup> (1991), 135 N.R. 61 (F.C.A.) [*Friedberg*]; aff'd [1993] 4 S.C.R. 285.

<sup>131</sup> *Ibid.* at 63

<sup>132</sup> *Ibid.* at 64.

With regard to the valuations, the Crown contested the findings of the Tax Court which accepted expert evidence of evaluators concerning the fair market value of the two collections of textiles, notwithstanding that these assessments far exceeded the actual sale price of the collections, and notwithstanding that the sales were contemporaneous with the donations to the ROM. The Tax Court had determined the fair market value of the two collections to be \$496,175 and \$229,437 (the approximate average of the three valuations in each instance), notwithstanding their sale prices of \$67,500 and \$12,000 respectively. The Federal Court of Appeal refused to interfere with the “finding of fact” on the issue of valuation, but Linden J.A. did note that he might have arrived at a different figure.<sup>133</sup>

When it allowed that “profitable gifts” were permitted within the tax incentive scheme for donations under the *ITA*, the Federal Court of Appeal opened the door wide to creative tax planning in relation to the cultural property tax incentives, and to the use of art and cultural property in relation to other donation incentives. Linden J.A. noted in *Friedberg*:

It is clear that it is possible to make a “profitable” gift in the case of certain cultural property. Where the actual cost of acquiring the gift is low, and the fair market value is high, it is possible that the tax benefits of the gift will be greater than the cost of acquisition. A substantial incentive for giving property of cultural and national importance is thus created through these benefits.<sup>134</sup>

In order to keep the cultural property tax incentive program from spiraling out of control as a result of the *Friedberg* decision, the government shifted its strategy away from focusing on the issue of fair market value in its taxpayer challenges. Administratively, amendments were introduced that gave the CCPERB an official role in making initial determinations of fair market value.<sup>135</sup> Following the *Friedberg* decision the government responded in the courts by shifting to the position that property purchased with a view to a quick donation should not be treated as capital, but rather as income account, negating the donor’s tax benefits for the donation.

In *Francoeur v. Canada*,<sup>136</sup> a case involving charitable donation, the appellants, who were not at the time engaged in buying and selling scientific material, purchased such material from a company in exchange

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<sup>133</sup> *Ibid.* at 66.

<sup>134</sup> *Ibid.*

<sup>135</sup> *Supra* note 110.

<sup>136</sup> [1993] 2 C.T.C. 2440.

for a charitable receipt. The company charged \$3,000 for the material and then transferred it to a charity which issued the appellants a charitable receipt in the amount of \$10,000. The appellants had no contact with the company either prior to or after the transaction in question; they purchased the material in order to make a gift of it to the charity and to receive the charitable receipt which could then be used as a deduction in their tax returns. They claimed their gain in this transaction was a capital gain. The Canada Revenue Agency (CRA) assessed their capital gain as business income. On appeal, the Tax Court of Canada held that this gain was in the nature of a capital gain and did not constitute “an adventure or concern in the nature of trade.” The Court found that the appellants envisaged no business profit at any time whatever, there was no financial risk or element of speculation for the appellants, and their purchase and disposition of materials for a charitable receipt was an isolated transaction.<sup>137</sup> The Court cited with approval Linden J.A.’s comments in the *Friedberg* decision regarding the possibility of “profitable gifts” under the legislation.<sup>138</sup>

The government tried the same approach in *Whent*, this time in connection with a donation of certified Canadian cultural property to designated institutions.<sup>139</sup> As in *Friedberg*, the CRA challenged the *Whent* valuations on assessment because this donation had been made prior to 1990, the date when responsibility for determining fair market value was transferred from what was then Revenue Canada to the CCFERB. In challenging the taxpayer, the government adopted the strategy pursued earlier in *Francoeur* and argued that the taxpayers’ gains in respect of the donations should be treated as being on income account.

The three taxpayers in *Whent* were law partners. In a 24-month period commencing in 1984, they purchased over 200 works of art by Norval Morrisseau, a Native artist from Northern Ontario. The aggregate price of the purchases was \$130,000. Soon after the purchase, the appellants decided to donate the works to various public art galleries. As a result, they claimed a twofold tax benefit. For the capital gain on the sale of Canadian cultural property, the deemed proceeds of disposition were equal to fair market value. If the value was greater than the owner’s cost, as in this case, the capital gain was exempt from tax. Second, the prescribed institutions issued a receipt for an amount equal to the fair market value of the gift. That amount was deductible in computing their taxable income. The Professional Art Dealers Association of Canada appraised the donated works at a fair market value of \$992,900.

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<sup>137</sup> *Ibid.* at 2446.

<sup>138</sup> *Ibid.*

<sup>139</sup> *Whent (TCC)*, *supra* note 8.

The Minister of National Revenue disallowed the deduction on the basis of that value, claiming this amount was far too high and that the transaction had been a venture in the nature of trade, rather than a sale of capital property; therefore, the appellants were not entitled to the twofold tax benefits.

The Tax Court of Canada allowed the taxpayers' appeals from their assessments for the 1984 through 1987 taxation years, allowed them to declare the property sold as capital property and, on the basis of expert testimony, determined its assessed fair market value at \$660,000.<sup>140</sup>

A number of factors were considered in determining whether a gain resulting from the acquisition and disposition of certain property was a capital gain or income from business. These included the nature of the property, the duration of ownership, the frequency of similar transactions, work expended to make the property more marketable, the circumstances responsible for sale and the motive.<sup>141</sup> The Tax Court found the appellants began purchasing the works because they were a bargain and had no idea what they would do with them. Donation of the property did not in itself determine the character of the property as capital or trading.<sup>142</sup> The Tax Court did not accept the Minister's argument that merely because the purchases were made at a bargain price they were meant to be traded. The appellants eventually heard about the tax advantage of donation and made a profitable gift. The property did not lose its capital status thereby.<sup>143</sup>

Both the Minister and the taxpayers appealed this decision to the Federal Court of Appeal.<sup>144</sup> The Federal Court of Appeal dismissed the Minister's appeal on the issue of characterization of the transactions, finding there was insufficient evidence to demonstrate that the taxpayers purchased the paintings with an intention to sell; their intention to purchase property on the basis that it was a bargain was not sufficient to establish that they were engaged in an adventure in the nature of trade, and their first few purchases could not colour subsequent purchases made with the knowledge of the tax advantages and with the intention to donate the paintings. The Court found that the majority of the purchases were made with a view to donating them, but noted that for an activity to qualify as a business, the profit must be anticipated to flow from the activity itself, rather than exclusively from the provisions of the taxing

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<sup>140</sup> *Ibid.* at para. 98.

<sup>141</sup> *Ibid.* at para. 11.

<sup>142</sup> *Ibid.* at para. 20.

<sup>143</sup> *Ibid.* at paras. 26-27.

<sup>144</sup> *Whent (FCA)*, *supra* note 8.

statute. Sexton J.A., citing *Loewen v. The Minister of National Revenue*,<sup>145</sup> commented:

Hugessen J.A. held that “tax considerations” and “an anticipated tax advantage” cannot “properly be determinative of whether or not any given transaction is a trading operation.” He added that “[w]hile the saving of taxes is clearly an important consideration in the conduct of any modern business, I do not think it can properly be said that a transaction whose sole purpose is to reduce the tax otherwise payable by a taxpayer is, for that reason alone, an adventure in the nature of trade.”<sup>146</sup>

Sexton J.A. also confirmed that the taxpayers’ intent to avail themselves of the cultural property gift tax incentives was consistent with the objectives of the legislation and permissible. He noted:

I would also add that the taxpayers’ donations are entirely consistent with the joint operation of the Act and of the Cultural Property Export and Import Act, and that to forbid the deductions sought by the taxpayers in the circumstances of this appeal would effectively frustrate those objectives. In *Art Gallery of Ontario v. Canada (Cultural Property Export Review Board)*, Rothstein J. addressed the objective that Parliament sought to fulfill when it provided the incentives it did:

The purpose of this legislation [i.e. the CPEIA] is to provide a mechanism to preserve the national heritage of Canada through a combination of export controls, preferential rights of purchase for designated cultural institutions and income tax incentives for those who donate Canadian cultural property to such designated institutions.

The basic scheme of the [CPEIA] and its companion provisions in the Income Tax Act is to combine an incentive — preferential tax treatment on the gift or sale of Canadian cultural property to designated institutions, with certain restrictions on the export of Canadian cultural property.<sup>147</sup>

On the question of valuation the Federal Court of Appeal dismissed the taxpayers’ cross-appeal, finding that the trial judge’s determination of value was reasonable.

In the proceedings before the Tax Court, four of the six witnesses who testified to the fair market value of the Morrisseau artwork were qualified as experts. One of the taxpayers’ experts valued the Morrisseau artwork at \$1,104,795. The original Professional Art Dealers Association of Canada appraisal submitted by the taxpayers to the galleries and

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<sup>145</sup> (1994), 94 D.T.C. 6265 (F.C.A.).

<sup>146</sup> *Whent (FCA)*, *supra* note 8 at 340.

<sup>147</sup> *Ibid.* at 340-41.

museums to which the paintings were eventually donated claimed that the fair market value of the artwork was \$992,900. By contrast, the Minister's experts valued the Morrisseau art at \$255,155.

The Court of Appeal noted that the Tax Court judge considered each expert's appraisal methods and, concluding that no one method was satisfactory, arrived at his own opinion of valuation based on the careful consideration of all the conflicting evidence. The Federal Court of Appeal found no error in his finding that \$660,000 was the fair market value.<sup>148</sup>

Arthur Drache, Q.C., who was lead counsel for the taxpayers before the Tax Court of Canada in *Whent(TCC)*, has pointed out that the CRA initially took the position that because the works were disposed of contemporaneously with their acquisition, their fair market value was in fact the purchase price and the charitable receipts were limited to that amount.<sup>149</sup> Mr. Drache noted that "immediately before the trial, the [Canada Customs and Revenue Agency as it then was] *de facto* abandoned this argument."<sup>150</sup>

Another important aspect of the valuation in *Whent(TCC)* was that the Tax Court judge would not accept the application of a block discount because the determination of fair market value contemplates purchasers and vendors acting without pressure to buy or sell. There was no evidence that the taxpayers were under any pressure to dispose of the Morrisseau art; in fact, their evidence was to the contrary. The judge found that their decision to give away all of the Morrisseau art within a 24-month period did not mean that they would have attempted to sell it within the same period had they decided to follow the sale route.<sup>151</sup> Accordingly, a block discount was not applicable.

In 1991 the CCPERB became responsible for making determinations of fair market value for the purpose of issuing cultural property income tax certificates. There was early dissatisfaction with the CCPERB's new role in this capacity. The view of donors and institutions suggested in news reports at the time was that the CCPERB was being overly conservative in its fair market determinations. Potential donors and institutions appeared to be of the opinion that objects for which certifications were being sought were being undervalued by the

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<sup>148</sup> *Ibid.* at 344.

<sup>149</sup> Arthur B.C. Drache, *Canadian Taxation of Charities and Donations*, (Thomson-Carswell, 1994) at 12-22.

<sup>150</sup> *Ibid.*

<sup>151</sup> *Whent (TCC)*, *supra* note 8 at para. 76.

CCPERB, creating a significant disincentive to cultural property donations.<sup>152</sup>

This frustration on the part of donors and institutions may explain the motivation behind an application for judicial review brought by the Art Gallery of Ontario challenging the refusal of the CCPERB to hold an oral hearing to determine fair market value of a collection which the Gallery felt was not given due consideration by the CCPERB. The Federal Court found that among the compelling reasons for ordering an oral hearing, two were prominent: 1) the credibility of the appraisal utilized by the CCPERB was suspect, and 2) breaches of the rules of natural justice or procedural fairness had been admitted.<sup>153</sup>

As a response to the *Art Gallery of Ontario* decision further amendments were made to the *CPEIA*, *ITA* and *Tax Court of Canada Act*<sup>154</sup> establishing appeals to the Tax Court of Canada on fair market value redeterminations by the CCPERB. An appeal may now be brought in the case of both sales and donations as long as the disposition has been made irrevocably and the powers of the CCPERB have been exhausted; in other words, it has made both a determination and a redetermination of fair market value. The donor or seller has an appeal as of right within ninety days after a cultural property income tax certificate has been issued. The Tax Court has power to confirm or vary the fair market value set by the CCPERB, and the value set by the Tax Court is considered to be a determination of the CCPERB for the purposes of the *ITA*.<sup>155</sup>

#### *Appeals of CCPERB Value Determinations*

Since the right of appeal was provided for ten years ago, there have been only three decided cases where appeals have been brought in connection with fair market value determinations by the CCPERB.<sup>156</sup> Not only were the valuations of the CCPERB upheld in each instance, but the courts in these decisions have clarified a number of issues pertaining to the valuation of art and cultural property, thereby contributing to closing the door so widely opened by the decisions in *Friedberg* and *Whent*.

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<sup>152</sup> Ann Duncan "Tissot is Sold for \$2 Million; Taxation Flap Sends Art Out of Canada" *The Montreal Gazette* (18 February 1993) D9.

<sup>153</sup> *Art Gallery of Ontario*, *supra* note 106 at para. 34.

<sup>154</sup> *An Act to Amend the Cultural Property Export and Import Act, the Income Tax Act and the Tax Court of Canada Act*, S.C. 1995, c. 38, ss. 2, 4, 6 and 9.

<sup>155</sup> *CPEIA*, *supra* note 32, ss. 33.1(1) and (2).

<sup>156</sup> *Aikman(FCA)*, *supra* note 6; *Maréchal (FCA)*, *supra* note 9; *Malette v. R.*, [2004] 4 C.T.C. 24 (F.C.A.) [*Malette(FCA)*].

*Aikman*, the first of these decisions, was an appeal from a decision by the CCPERB which redetermined the value of a Cyclo-Crane, a disassembled prototype (or, more accurately, a proof-of-concept) of a lighter-than-air, heavy-lift vehicle, which was donated to the Canadian Museum of Flight and Transportation in Langley, British Columbia.<sup>157</sup> The donors estimated the Cyclo-Crane to have a fair market value of US\$3,075,000, while the CCPERB determined that it had a value of US\$200,000.

*Aikman* and the others claimed that the value of the Cyclo-Crane should have been determined based on its current physical condition, the cost to reproduce it, the history of any similar object sales, potential marketability and outside interest, historic or collectible value, cultural or technological importance and rights or privileges. The CCPERB based its decision on an amount suggested by an officer of one of the forestry companies which had participated in the early funding of the prototype project .

The Tax Court of Canada dismissed the *Aikman* appeal. The Tax Court held that the evidence did not support a fair market value that exceeded US\$200,000. The Court found that Cyclo-Crane was of unique historical interest, but that did not create a market where none existed. The Tax Court did not accept the replacement cost or the cost of the Cyclo-Crane as a good indication of fair market value. In holding that the vehicle did not support a fair market value in excess of US\$200,000, the Court affirmed the CCPERB's finding that there was no market for the Cyclo-Crane as there were practical problems with respect to its operation.

The taxpayers' appeal to the Federal Court of Appeal was dismissed.<sup>158</sup> The Federal Court of Appeal accepted the Tax Court's conclusion that there was no market for the Cyclo-Crane,<sup>159</sup> and held that the judge was entitled to reject the evidence given by the appellants' experts, notwithstanding that the US\$200,000 value assigned by the CCPERB was higher than that given by either of the respondent's experts.<sup>160</sup> The decision in *Aikman* underlines the importance of not losing sight of the plain meaning of the words "fair market value" in the determination of valuation. As Bowman T.C.J. noted,

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<sup>157</sup> *Aikman*(FCA), *ibid.*

<sup>158</sup> *Ibid.*

<sup>159</sup> *Ibid.* at 149.

<sup>160</sup> *Ibid.* at 149-50.

The “cost” of the object, insofar as it is relevant in the determination of fair market value means, in my view, at least in the circumstances of this case, the price at which the object changed hands in an arm’s length situation. It does not encompass the substantial cost of developing and producing the Cyclo-Crane proof-of-concept, either with or without the research and development costs. Some effect must be given to the plain meaning of the words “fair market value” (juste valeur marchande). What it cost historically to produce a prototype, or what it might cost to reproduce it, might have nothing to do with what price the object would command on the open market. It might be much higher or much less. I am sure that the actual cost of reproducing Lindbergh’s Spirit of St. Louis, or the plane the Wright brothers flew in would be significantly less than what a wealthy collector or museum would pay for the originals of these aircraft. Conversely, the cost of reproducing an object might well be far in excess of the price it could fetch on the open market.<sup>161</sup>

The second of the three CCPERB appeal decisions, *Malette v. Canada*,<sup>162</sup> concerned an appeal by participants in a tax shelter scheme who had donated 981 paintings of Harold Feist, a mid-career contemporary artist from Atlantic Canada, to a public art gallery. The taxpayer alleged that the value of the paintings totaled \$879,714, but the CCPERB arrived at a value of \$293,246.

Before the Tax Court of Canada, the taxpayer’s appeal was allowed in part. Despite a discrepancy between the English and French versions of section 33.1 of the *CPEIA*, the Court found the plain meaning of the various sections of this statute and the *ITA* required the Court to determine the “fair market value,” not just the “market value,” of the items in issue. The argument between the parties was whether the fair market value of the works should be determined individually or as a group, subject to a blockage effect when a mass of the works are sold together. The CCPERB valued each object individually, and then gave each a bulk discount of 90 percent based on the premise that the disposition had occurred in the “tax shelter market.” Applying the analysis in *Whent*, the Court rejected the concept of a blockage effect with reference to a donation to a public gallery. Since no bulk discount was applicable, the Court found that the works of art had to be valued at \$828,000 and accordingly, it varied the valuation determination of the CCPERB.<sup>163</sup>

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<sup>161</sup> *Aikman (TCC)*, *supra* note 6 at para. 109.

<sup>162</sup> *Malette v. R.*, [2004] 1 C.T.C. 2125 (T.C.C.) [*Malette (TCC)*]; *rev’d Malette (FCA)*, *supra* note 156.

<sup>163</sup> *Malette (TCC)*, *ibid.* at 2133.

The Crown appealed the decision of the Tax Court of Canada to the Federal Court of Appeal.<sup>164</sup> The Crown argued that the Tax Court erred in holding that a discount should not be applied when determining the fair market value of a block of art works donated to a public gallery. The Federal Court of Appeal held that the need to apply a block discount was a function of supply and demand, that block discounts were an accepted principle of proper valuation methodology and that nothing in the Act authorized a departure from accepted valuation principles and methodology. The Federal Court of Appeal did not agree with the Tax Court of Canada's interpretation of the word "object" in its singular form in the legislation, holding that if Parliament wished to depart from the accepted meaning of fair market value it would do so expressly. Noël J.A. distinguished and clarified the decision in *Whent* as it related to the application of a block discount in valuation determinations:

It is true that in *Wendt* [sic], Mogan J. refused to apply a blockage discount, but this was because he did not believe that such a discount was appropriate based on the evidence before him. In particular, he accepted expert testimony to the effect that the 216 art works in issue in that case could be sold on the relevant market over the two years during which the donations were made without there being a negative impact on individual prices. Nowhere does Mogan J. suggest that blockage discounts cannot be applied as a matter of statutory construction.

I also note that the application of a blockage discount was not in issue in the ensuing appeal to this Court as the Minister did not challenge Mogan J.'s determination that a blockage discount was inappropriate in the circumstances of that case.<sup>165</sup>

Finding the application of a block discount in the determination of fair market value appropriate in the circumstance of this case, the Federal Court of Appeal allowed the Crown's appeal and confirmed the fair market value certified by the CCPERB.

Finally in *Maréchal*<sup>166</sup> the taxpayer challenged the CCPERB valuation of \$5,000 for a sculpture donated to the Montreal Museum of Fine Arts. The Tax Court of Canada noted that the appellant, Mr. Maréchal, was highly qualified in the field of art (he had a Master's degree in art history and was the curator of the art collection of Power Corporation). Based on two valuations from art dealers provided to the CCPERB, he argued that the value of the sculpture at the time of its donation to the Museum was \$8,000 and that it was arbitrary and unjustified for the CCPERB to substitute its own figure of \$5,000. There

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<sup>164</sup> *Malette (FCA)*, *supra* note 156.

<sup>165</sup> *Ibid.* at 32.

<sup>166</sup> *Maréchal(TCC)*, *supra* note 9.

is no informal procedure available for CCPERB valuation appeals; therefore, representing himself, the taxpayer had to proceed with his appeal under the general procedure notwithstanding the small amounts involved.<sup>167</sup> The Court noted the difficulties in valuing works of art<sup>168</sup> and proceeded to confirm the Board's evaluation of \$5,000.<sup>169</sup> The appellant's appraisal reports themselves did not constitute evidence that would justify the conclusion that the sculpture had increased in value 500 percent in the eleven months between the time of purchase and the time of donation to the Montreal Museum of Fine Arts in November, 2000.<sup>170</sup>

The Federal Court of Appeal dismissed the appeal, stating that had the appellant called expert witnesses to explain some of the concerns raised by the Tax Court, the outcome might have been different. The Court of Appeal found, however, that the Tax Court judge made no error in accepting the evidence before him that the best indicator of the sculpture's value was the price paid for it by the taxpayer multiplied by a factor of approximately three, to take into account the fact that he had bought the sculpture at a public auction. Accordingly the Federal Court of Appeal affirmed the CCPERB evaluation of \$5,000 for the donated object.<sup>171</sup>

In *Maréchal(TCC)* Bowman A.C.J.T.C., who had heard a number of art valuation cases,<sup>172</sup> noted that caution was warranted in treating artistic merit as a factor in determining value.<sup>173</sup> He also noted that there may be an element of arbitrariness in valuing works of art:

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<sup>167</sup> *Ibid.* at paras 11 and 12. The Tax Court judge took note of the small amount in dispute and allowed the appellant certain procedural and evidentiary concessions in view of this and the fact that he was self-represented.

<sup>168</sup> *Ibid.* at para 15.

<sup>169</sup> *Ibid.*

<sup>170</sup> *Ibid.* at para. 24. Bowman, A.C.J.T.C. noted: "Ms. Millar, an experienced art expert, has taken the price paid in 1999 and has arrived at a value that is approximately double that a year later. The Board has trebled or quadrupled it and the appraisers Devlin and Blais have quintupled or sextupled the original cost depending upon what figure one starts with. I do not think that the reports of Devlin and Blais contain within themselves the type of evidence that would justify the conclusion that this work of art has appreciated in value by 500 percent. It may be that so dramatic an increase is theoretically possible in extraordinary circumstances but in the real world it seems highly improbable and it has not been established here."

<sup>171</sup> *Maréchal(FCA)*, *supra* note 9.

<sup>172</sup> Bowman A.C.J.T.C. [now C.J.T.C.] was the Tax Court of Canada judge in the decisions in both *Aikman v. Canada*, [2000] T.C.J. No. 72 and *Klotz*, *infra* note 188.

<sup>173</sup> *Maréchal(TCC)*, *supra* note 9 at paras. 21 and 22; Bowman, A.C.J.T.C. noted: "Defining and recognizing artistic merit is almost as difficult as defining art itself. No doubt art experts and artists are in a better position than a court would be to determine whether a work of art has artistic merit. Nonetheless, it is an elusive and indefinable

One cannot entirely escape an element of arbitrariness in valuing artistic works...what one person may call arbitrariness, someone else may call informed discretion and someone else may call judgment based on experience. It depends on who is making the call.<sup>174</sup>

Since the right of appeal from fair market value determinations by the CCPERB was provided in 1996, there have been 14 appeals by taxpayers, of which eight were discontinued during pre-trial procedures, one was settled and one dismissed.<sup>175</sup> In all three appeals that did proceed to trial, *Aikman*, *Malette* and *Maréchal*, the taxpayers were ultimately unsuccessful at the Federal Court of Appeal.

There are limitations in assessing the efficacy of the cultural property gifting program from the point of view of the contest between the taxpayer and government in relation to the issue of valuation. The CCPERB does not make its files publicly available, taking the position that the materials in its files pertaining to deliberations in this area constitute “taxpayer information” subject to protection under section 241 of the *ITA*,<sup>176</sup> and it is only very recently that a comprehensive report on its activities has become available to the public. Anecdotal reports can be only suggestive as avenues for investigation.<sup>177</sup> Moreover, notwithstanding the publicly stated views of the stakeholders, their real motivations cannot be known.<sup>178</sup> In the few decided appeals from CCPERB valuations the taxpayer has not been successful. What inferences may be drawn from the limited number of appeals to the Tax Court from CCPERB? Such appeals can only arise where the donor has already irrevocably disposed of the object. Donors unhappy with a CCPERB evaluation could simply withdraw from the certification

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concept and it is unquestionably highly subjective. I would be reluctant to base any determination of value upon the view of an art expert - however distinguished - that a work of art had artistic merit.... I accept as well that the determination of artistic merit is not necessarily in all cases a purely subjective or relativistic one. Obviously, there are objective criteria that can be applied. Rembrandt's works have by all objective standards artistic and aesthetic merit. No doubt the fact that objectively his works have artistic merit as well as the fact they are by Rembrandt justifies, at least in part, the high prices. However, we are not trying to value a Rembrandt here. I am merely indicating that caution should be used in treating the subjective judgment on the presence or absence of artistic merit as a factor in determining the fair market value of a work of art.”

<sup>174</sup> *Ibid.* at para. 23.

<sup>175</sup> *Cumulative Report*, *supra* note 26 at 9.

<sup>176</sup> *Information Commissioner*, *supra* note 3.

<sup>177</sup> See e.g. *supra* note 152. Can any inferences be drawn from the lack of news reports indicative of donor or institutional dissatisfaction with CCPERB determinations since the amendments to the CPEIA to allow for donor appeal of CCPERB valuations?

<sup>178</sup> P. Van Harten, “\$35,000 Painting Valued at \$2.38 Million Museum Donation Nets Philanthropist \$500,000 Deduction” *Toronto Star* (17 February 2001) A12.

process. The figures suggest that this avenue is used relatively rarely. In the years 1992 through 1997, of 5,840 applications determined and redetermined by the CCPERB, 196 applications for certification were withdrawn by applicants; in the years 1997 through 2005, of 7,969 applications determined and redetermined by the CCPERB, only 35 applications for certification were withdrawn by applicants.<sup>179</sup> From the declining number of withdrawn applications for certification in the past nine years, the limited number of taxpayer appeals from CCPERB determinations and the lack of recent anecdotal reports reflective of donor or institutional dissatisfaction since the appeal process was introduced in 1996, it would appear that stakeholders with an interest in the cultural gifting tax incentive program are content with the current state of affairs. The CRA has no appeal from the CCPERB determinations of value, so it seems reasonable to infer that since no modifications have been made to the program since the 1996 amendments, the government is also content with the way the program is working.

What is clear, however, is that on the question of valuation recent decisions have reduced significantly the laissez-faire approach of the courts to tax planning consequences of the “profitable gift” concept evident in the *Friedberg*<sup>180</sup> and *Whent (FCA)*<sup>181</sup> decisions. In *Malette(FCA)*<sup>182</sup> the Court allowed for the concept of a blockage discount in appropriate circumstances, notwithstanding this argument had earlier been rejected in *Whent*. In *Maréchal (FCA)*<sup>183</sup> the Court entertained an argument not raised in *Friedberg* concerning the relevance of a contemporaneous purchase price to the valuation of the donated object. In the latter respect the courts may have come full circle from the *Friedberg* decision, which opened the door to the “art-flip” and “buy low/donate high” tax shelter schemes (now closed by amendments to the *ITA*),<sup>184</sup> in the recent decision of the Federal Court of Appeal on the

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<sup>179</sup> *Cumulative Report*, *supra* note 26 at 35; *Annual Report*, *supra* note 51 at 78.

<sup>180</sup> *Supra* note 128.

<sup>181</sup> *Supra* note 8.

<sup>182</sup> *Supra* note 152.

<sup>183</sup> *Supra* note 9.

<sup>184</sup> It is beyond the purview of this paper to discuss the area of charitable gifts relating to the “art-flip” tax shelter schemes and the government’s response; for discussions related to this topic see: P. Boyle “Charitable Gifts: An Update,” *Report of Proceedings of Fifty-Sixth Tax Conference, 2004* (Toronto: Canadian Tax Foundation, 2005); D. Sandler and T. Edgar, “The Tax Expenditure Program for Charitable Giving: Kicking a Gift Horse in the Teeth” (2003) 51 *Canada Tax Journal* 2193-2214; C.J.F Richardson, “Update on Taxation of Charities and Charitable Giving,” *2003 British Columbia Conference* (Vancouver: Canadian Tax Foundation, 2003) at 9:1-18; D.P. Stevens, “Update on Charitable Taxation,” *Report of Proceedings of Fifty-Third Tax*

question of valuation in *Nash v. Canada*.<sup>185</sup>

*Nash — Shutting the Door on “Art-Flips”*

In *Nash(FCA)* the Federal Court of Appeal has clearly stated that where the acquisition of donated property occurs within a short time frame prior to the time of donation, the most probative evidence of the fair market value of the donated object may be the amount the donor paid for the object.<sup>186</sup>

Although *Nash* arose in the circumstances of appeals from assessments in relation to receipted donations pertaining to an “art-flip” tax shelter scheme, and not under the certified cultural gift program, the main issue in this case concerned the fair market value of the donated art works. On appeal of the assessments by the CRA, the Tax Court of Canada found that the fair market value for a group of prints donated by taxpayers to charities was the appraised value of the individual prints.<sup>187</sup> The Tax Court’s decision in *Nash(TCC)* was inconsistent with that Court’s decision in *Klotz v. R.*,<sup>188</sup> affirmed on appeal to the Federal Court of Appeal<sup>189</sup> where, notwithstanding the similar circumstances, the Tax Court denied the taxpayer’s appeal from the Minister’s decision and held that the best evidence as to the value of the art was what the taxpayer had paid for it. In *Nash(FCA)* the Federal Court of Appeal allowed the Crown’s appeal. The Court of Appeal found that because the prints were sold in groups, the relevant asset for valuation was a group of prints, not the individual prints; it was wrong to assume that the fair market value of the group of items was the aggregate of the price that could be obtained for individual items in the group. Rothstein J.A. allowed that in some circumstances blockage may be appropriate, noting:

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*Conference, 2001* (Toronto: Canadian Tax Foundation, 2002) at 28:1-41; J. M. Pappin, “December 20, 2002 Draft Technical Changes — Charitable Donations, Charities and Trusts,” *2003 Ontario Tax Conference*, (Toronto: Canadian Tax Foundation, 2003) at 5:1-32.

<sup>185</sup> *A.G. of Canada v. Nash et al.* [2006] 1 C.T.C. 158 (F.C.A.) [*Nash (FCA)*].

<sup>186</sup> *Ibid.* at para. 29.

<sup>187</sup> *Nash v. R.*, [2005] 1 C.T.C. 2138 (T.C.C.) [*Nash (TCC)*]. The taxpayers donated a group of limited edition prints to a charity or university through a program operated by CVI Art Management Incorporated. CVI sold groups of prints to individuals, arranged for appraisals and located charities to accept the gifts. The taxpayers became entitled to a tax credit in respect of the donation based on the fair market value of the property. The charity or university issued an official tax receipt to them based on an appraisal value.

<sup>188</sup> [2004] 2 C.T.C. 2892 (T.C.C.).

<sup>189</sup> [2005] 3 C.T.C. 78 (F.C.A.) [*Klotz (FCA)*].

When a court is required to determine the fair market value of an asset for which there is no market that permits a direct comparison, it may be necessary to consider the transactions in some other market, subject to such adjustments as may be appropriate to the case, such as a blockage or volume discount. But where there is a market in which assets of the description of the asset being valued are traded, there is no need for the use of a proxy.<sup>190</sup>

In *Nash(FCA)* the Federal Court of Appeal also found there was a market for the specific group of prints in the circumstances of this case, and that was the price paid by the taxpayers, which was the highest price attainable for the prints. The Court of Appeal approved the approach taken by the Tax Court in *Klotz* as logical and self evident.<sup>191</sup> Rothstein J.A. noted:

The Tax Court Judge made two palpable and overriding errors. The first was to accept Ms. Tropper's valuation evidence based on the retail market for individual prints when there was a normal market for the groups of prints, the specific property he was required to value. The second was to find the fair market value of the property to be approximately three times the amount paid for the property with no credible explanation for the apparent three-fold increase.<sup>192</sup>

In *Nash(FCA)* the Federal Court of Appeal confirmed the following principles as being applicable to the valuation of the fair market value of works of art. First, the well-accepted definition of fair market value set out as follows by Cattanach J. in *Henderson Estate and Bank of New York v. M.N.R.* is the working definition to be applied:

the highest price an asset might reasonably be expected to bring if sold by the owner in the normal method applicable to the asset in question in the ordinary course of business in a market not exposed to any undue stresses and composed of willing buyers and sellers dealing at arm's length and under no compulsion to buy or sell.<sup>193</sup>

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<sup>190</sup> *Nash (FCA)*, *supra* note 185 at para. 24.

<sup>191</sup> *Ibid.* at para. 35.

<sup>192</sup> *Ibid.* at para. 37.

<sup>193</sup> (1973), 73 D.T.C. 5471 at 5476: "The statute does not define the expression 'fair market value', but the expression has been defined in many different ways depending generally on the subject matter which the person seeking to define it had in mind. I do not think it necessary to attempt an exact definition of the expression as used in the statute other than to say that the words must be construed in accordance with the common understanding of them. That common understanding I take to mean the highest price an asset might reasonably be expected to bring if sold by the owner in the normal method applicable to the asset in question in the ordinary course of business in a market not exposed to any undue stresses and composed of willing buyers and sellers dealing at arm's length and under no compulsion to buy or sell. I would add that the foregoing understanding as I have expressed it in a general way includes what I conceive to be the

Second, where there is no direct comparison market, it may be necessary to consider the transactions in some other market subject to appropriate adjustments.<sup>194</sup> Third, blockage or volume discounts are appropriate adjustments depending upon the circumstances.<sup>195</sup> Finally, where the dates of acquisition and disposition are very close in time, barring evidence to the contrary, the cost of acquiring the asset will likely be a good indicator of its fair market value.<sup>196</sup>

*Nash* will have implications for valuations of cultural property under the CCPERB certification program. *Nash* also continues the trend found in the decisions of appeals from CCPERB valuation determinations that constrain taxpayers in their efforts to support higher valuations of donated cultural property. In particular, in circumstances such as those in *Friedberg* where the dates of acquisition and disposition are very close in time, the cost of acquiring the object should have a strong bearing on its fair market value, absent evidence to the contrary. It is very likely *Friedberg* would be decided differently today.

An extension of time for a leave application to the Supreme Court of Canada was granted to the taxpayer in *Klotz* pending determination by the Federal Court of Appeal in *Nash*.<sup>197</sup> The Supreme Court of Canada recently dismissed the taxpayers' applications for leave to appeal from the judgments of the Federal Court of Appeal in both *Nash* and *Klotz*.<sup>198</sup> Accordingly, nothing more will be forthcoming from the Supreme Court of Canada on the issue of valuation in relation to those decisions.<sup>199</sup>

### Conclusion

An examination of the income tax incentive program which supports cultural gifting in Canada by scrutinizing the disputes which have arisen

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essential element which is an open and unrestricted market in which the price is hammered out between willing and informed buyers and sellers on the anvil of supply and demand.”

<sup>194</sup> *Nash (FCA)*, *supra* note 185 at para. 24.

<sup>195</sup> *Ibid.* at para. 21.

<sup>196</sup> *Ibid.* at para. 29.

<sup>197</sup> [2005] S.C.C.A. No. 286 (June 20, 2005).

<sup>198</sup> Supreme Court of Canada Bulletin of Proceedings, April 21, 2006.

<sup>199</sup> There is a minor divergence between the decisions in *Nash (FCA)*, *supra* note 185, and *Klotz (FCA)*, *supra* note 189, in the Federal Court of Appeal concerning the nature of the valuation question; in the former decision, the Court found this to be a mixed question of fact and law, the dominant component of which is factual, and in the latter decision the Court found it to be a question of fact. That divergence notwithstanding, the Court in both decisions found the standard of review to be the deferential standard, of “palpable and overriding error.”

amongst its stakeholders is necessitated by the narrow scope of the policy discussion in this area. The focus in that respect has concerned issues of valuation. Valuation determines the benefit to the donor/taxpayer, the consequential indirect subsidy to the institution and the tax expenditure by way of foregone revenue to the government. To a certain extent the choice of instrument in the area of arts and cultural property forecloses broader public discussion; after all who really cares if Mel Lastman gets a tax break for donating copies of his old speeches to the City of Toronto — “n-o-o-o-body!” However, the tenor of the discussion would change significantly if the Government of Canada were to directly subsidize the purchase of the former Mayor’s speeches.

So far as the certified cultural gifting program is concerned, the testing of the expenditure through examining the disputes over valuation would suggest that the stakeholders are relatively satisfied their objectives are being met. Recent decisions in the Courts have clarified the applicable principles relating to valuation and narrowed the possibilities for abuse. That there is no broader debate and that the program has persisted without significant change for ten years may be confirmation of a general satisfaction with the current state of affairs. The historical lack of comprehensive public information regarding the program has been an obstacle to a more complete study of its hidden costs, direct benefits, and indirect subsidies to the applicable stakeholders. It is hoped that the very recently released comprehensive report by the Department of Canadian Heritage on the activities of the CCPERB and any similar insights into its deliberations to be made available in future will facilitate further study and provide a useful basis to broaden the policy discussion.