Looking the Gift Horse in the Mouth: An Examinatiou of Charitable Gifts Which Beuefit the Donor

Ellen B. Zweibel*

The author deals with the problem of gifts which benefit the donor in the light of the charitable donation deduction sections of the *Income Tax Act*. The tax policy consideration underlying the sections, namely the promotion of charitable giving, may come into conflict with the *Act*'s prohibition on deductions for purely personal expenditures and the desire to avoid giving charitable organizations an unwarranted competitive advantage. Recent decisions of the Federal Court of Canada have revealed the confusion in this area and the need for a clear definition of "gift". Using American, Australian and Canadian case law as background, the author formulates a three-tiered test to distinguish a charitable gift from an ordinary business transaction which may have been entered into by a charitable organization.

Cet article porte sur la déduction pour contributions aux oeuvres de charité et en particulier sur la définition d'un « don » pour les fins de la *Loi de l'impôt sur le revenu*. Après avoir fait état de l'incertitude et de l'insatisfaction qui règnent en droit canadien suite à des décisions récentes en provenance de la Cour fédérale sur cette question, l'auteur met en évidence les aspects politiques fiscales sous-jacentes à cette déduction. Notamment, la prohibition par la *Loi* des déductions pour dépenses purement personnelles et l'intention d'éviter de donner aux organisations charitables un avantage indu font obstacle à la politique fiscale d'encourager les donations charitables. En s'inspirant de la jurisprudence américaine, australienne et canadienne, l'auteur élabore trois tests susceptibles de promouvoir ces politiques fiscales. L'auteur en arrive à la conclusion qu'une combinaison des trois tests serait la solution optimale.

*Of the Faculty of Law, Common Law Section, University of Ottawa.

Synopsis

* * *

Introduction

We all know that it is better to give than to receive. When the gift is to a qualified charity, this old adage has an additional meaning because the donor is entitled to an income tax deduction under the *Income Tax Act* paragraph 110(1)(a).[1] The question then becomes: If the reward to the donor goes beyond the general feeling of personal satisfaction to which the adage refers, and includes some economic benefit, should the gift still qualify for the tax deduction?

[1]Citations are to the *Income Tax Act*, S.C. 1970-71-72, c. 63, as am., unless otherwise indicated [hereinafter *ITA*].

In return for my annual donation to public television, I receive personal satisfaction in sponsoring non-violent children's programming, personal entertainment in watching movies without commercial interruption, and educational benefits for my three-year-old every weekday might when the "Polka Dot Door" both instructs and babysits her from 6:00 to 6:30. I also receive a charitable donation receipt for income tax purposes. I could obtain similar personal, educational and entertainment benefits by purchasing a VCR along with programs of my own selection. However, no one would suggest that these personal expenditures should be tax deductible.

Charitable gifts are personal expenditures in the fullest sense. They are inspired by a mixture of personal motives, even the most altruistic of which reflect and promote the donor's personal viewpoints. To escape *ITA* paragraph 18(1)(h)'s prohibition on the deduction of personal expenditures, charitable donations require a specific deduction provision. This legislative concession probably reflects a general perception that charitable giving should be encouraged, rather than an empirical finding that charitable activity is effectively promoted by a system of tax deductions. This paper will leave aside the debate on the appropriateness of our present system.[2] Rather, it will examine what, if any, limits there should be on deductibility when the donor receives tangible benefits because of his or her charitable gift.

The issue is not a new one. It has previously arisen in Canadian tax cases, primarily in two contexts: the purchase of tickets to a charity-sponsored event, and payments to parochial schools by parents of children attending the school. A compromise approach has evolved whereby Revenue Canada now accepts the dual character of these payments and apportions them into a non-deductible personal amount and a deductible charitable gift.

The compromise has recently started breaking down. This is in part because it has been limited to a few situations, and has not been applied to the many other miscellaneous benefits that donors receive. Hence recently, in *Burns* v. *Minister of National Revenue*,[3] Revenue Canada challenged the deductibility of a donation to the Canadian Ski Association because the organization was training the donor's daughter as a world class ski competitor.

More importantly, the compromise is failing because it lacks, as a basis, a comprehensive definition of charitable gift that incorporates tax policy considerations. Thus, in *McBurney* v. *R.*,[4] the Federal Court Trial Division

---

[2]See R.W. Boadway & H.M. Kitchen, *Canadian Tax Policy*, 2d ed. (Toronto: Canadian Tax Foundation, 1984) at 71-74; R.M. Bird & M.W. Bucovetsky, *Canadian Tax Reform and Private Philanthropy* (Toronto: Canadian Tax Foundation, 1976) at 4-10; G. McGregor, "Charitable Contributions" (1961) 9 Can. Tax J. 441.

[3](1983), [1983] C.T.C. 2629, 83 D.T.C. 557 (Tax Ct) [hereinafter *Burns*].

[4](1984), [1984] C.T.C. 466, 84 D.T.C. 6494 [hereinafter *McBurney* (T.D.)].

allowed a deduction for the entire amount paid by a parent to the private, religious elementary school attended by his children. The decision was based essentially on a definition of gift rooted in contract law. It was recently appropriately overturned by the Federal Court of Appeal.[5] However, the appellate decision still falls short of providing a complete definition of charitable gift for income tax purposes.

I. The Canadian Compromise

With respect to charity-sponsored events, the Minister of National Revenue's original stance was to disallow any deduction, viewing the entire admission payment as falling outside the legal meaning of a gift. This was first successfully challenged in *Aspinall* v. *Minister of National Revenue*.[6] The taxpayer, an executive member of the National Ballet Guild of Canada, paid a $150 admission fee to attend a Guild-sponsored fund-raising performance and reception. The regular price of admission to the event was $65. The taxpayer deducted the $85 premium as a charitable donation. The Guild had only issued a donation receipt for $42, because unforeseen expenses had reduced the event's net profit and hence the actual amount available for the organization's charitable activities. The Minister disallowed the entire deduction.

The taxpayer's first hurdle was to show that the extra $85 was intended to be a gift, as opposed to a purely commercial payment. This was analyzed from both the taxpayer's and the charity's perspective. The Tax Appeal Board quoted at length from Mr Aspinall's direct testimony to the effect that he, and other subscribers, were aware that they were paying a premium and that they intended thereby to make a gift. Likewise, the Board noted that the Guild, in its solicitations and in the reception program, acknowledged the financial support of those in attendance.

Having accepted the divisibility of the admission fee into entertainment and charitable components, the Tax Appeal Board was left with a valuation question. It applied a bargain sale analogy, using the regular admission price as the fair market value and treating the excess amount as a gift. The use of some of the excess to defray unexpected expenses was not considered relevant, because all charitable donations go in part to defray administrative expenses.

Interpretation Bulletin IT-110R now accepts the basic principle established in *Aspinall* that part of the price of admission to a charity event can

[5] *R.* v. *McBurney* (1985), [1985] 2 C.T.C. 214, 85 D.T.C. 5433 [hereinafter *McBurney* (A.D.)].
[6] (1970), [1970] Tax A.B.C. 1073, 70 D.T.C. 1669 [hereinafter *Aspinall* cited to Tax A.B.C.].

be a gift. The fair market value of the admission price is used to measure the entertainment component.[7]

Information Circular 75-23 presents the compromise position on religious school tuition.[8] Payments to religious schools are divisible into a personal non-deductible expenditure for secular education, and a deductible charitable donation for religious instruction.[9] Two methods are provided for evaluating the deductible and non-deductible components. The appropriate method depends on whether the school itself has segregated its costs for providing secular and religious training. Both methods arrive at a per pupil cost and allow a deduction for payments in excess of that cost.[10] Under both methods, contributions to the school by non-parents will result in an increase in the deductible component.

The Information Circular's basic approach was employed in *R.* v. *Zandstra.*[11] The Federal Court Trial Division disallowed a charitable deduction to the extent that the amount reflected the per pupil cost of religious elementary school education for the taxpayers' children.[12]

II. The Compromise Unravelling

The common law definition of charity tends to expand to reflect society's changing views and needs.[13] As "charity" widens to include sports, arts and cultural activities, the likelihood increases that donors may be directly

[7]Interpretation Bulletin IT-110R, "Charitable Donation and Like Receipts: Tickets and Special Fund-raising Events", 20 February 1984, paras 2 and 3.

[8]Information Circular 75-23, "Tuition Fees and Charitable Donations Paid to Privately Supported Secular and Religious Schools", 29 September 1975.

[9]Underlying this compromise is a basic premise that any payment for exclusively religious instruction is *per se* for the advancement of religion, and hence charitable. However, to be charitable, the religious activity must still provide a public benefit.

The classic statement on charitable religious activity, in *Cocks* v. *Manners* (1871), L.R. 12 Eq. 574 at 585, makes a distinction between providing religious instruction to one's self and family and making religious instruction available to the public.

The Information Circular disregards this possible distinction. For a case indicating a similar shift away from *Cocks* v. *Manners* see, generally, *Neville Estates Ltd* v. *Madden* (1961), [1962] Ch. 832, [1961] 3 All E.R. 769.

[10]If the school can divide its costs between secular and religious training, then the parents can deduct the full amount paid for religious training. If the school does not separately account for its costs, then only the amount paid in excess of the total per pupil cost for both secular and religious training is deductible. See Information Circular 75-23, paras 7 and 9.

[11](1974), [1974] C.T.C. 503, 74 D.T.C. 6416 [hereinafter *Zandstra*].

[12]An earlier case, *No. 688* v. *Minister of National Revenue* (1960), 23 Tax A.B.C. 400, 60 D.T.C. 130 [hereinafter *No. 688* cited to Tax A.B.C.], disallowed a parent's full contribution to a private Hebrew school. If Information Circular 75-23 had been in effect, a partial deduction would have been allowed. See also *Homa* v. *Minister of National Revenue* (1969), [1969] Tax A.B.C. 961, 69 D.T.C. 673; *Koetsier* v. *Minister of National Revenue* (1973), [1974] C.T.C. 2011, 74 D.T.C. 1001 (Tax Rev. Bd).

[13]See, generally, *Re Laidlaw Foundation* (1984), 48 O.R. (2d) 549, 13 D.L.R. (4th) 491 (H.C.).

involved in a charity's activities, and thereby receive some type of benefit. Although an apportionment approach may still be a viable solution to the donor benefit problem, its application is not always as apparent and straightforward as in the admission fee situations set out in Interpretation Bulletin IT-110R.

This was the problem presented to the Tax Court in *Burns*, where the taxpayer's daughter received ski training concurrently with his donations to the Canadian Ski Association. Taylor J.'s opinion gropes for a standard for determining when a gift has been made, ultimately settling on the taxpayer's primary motivation as the test. Some important points are raised in the process.

First, the Minister could have justified the denial of a charitable deduction by proving the existence of a contract for services, regardless of what the parties called the payments. To this end the Minister introduced evidence showing the extreme pressure placed on parents to make contributions. Some letters from the Canadian Ski Association even contained an implicit threat that training would be discontinued unless donations were forthcoming. Judge Taylor considered this evidence insufficient to establish a contract. However, he made a significant point — that while the existence of a contract would destroy the gift, the *absence* of a contract did not in itself prove there was a gift.[14]

Although Judge Taylor reiterated a debate between counsel on whether "consideration" is synonymous with "benefit", he avoided approving any particnlar defimition of consideration by focusing instead on the taxpayer's motive. However, using motive as the main test raised a further problem. The taxpayer, by his own admission, had mixed charitable and personal motives for making the donations. Judge Taylor implicitly rejected any requirement that the taxpayer's motive be exclusively charitable by finding that Dr Burns' primary motive was to support the public objectives of the Canadian Ski Association and that his secondary or ancillary family considerations did not undercut the primary motive sufficiently to vitiate the gift.[15]

Several factors were used to rank the relative importance of the taxpayer's charitable and personal motives. First, his long-standing support of the Canadian Ski Association was seen as evidence of his commitment to the charity's general objective of producing world-class Canadian skiers.

---

[14]*Burns, supra,* note 3 at 2631 (C.T.C.), 559 (D.T.C.):

> But that does not relieve this appellant from convincing the Court that the amounts at issue qualify as "gifts" and it is not sufficient that counsel for the appellant highlight the distinctions which might be seen from a "contract".

[15]*Ibid.* at 2633 (C.T.C), 560 (D.T.C.).

Second, even his specific interest in his daughter's ski training was interpreted as an interest in fulfilling the charity's mandate. The rationale for this interpretation was that Dr Burns' narrow personal objective could have been accomplished through private lessons, whereas producing a Canadian world champion could only be done under the Association's auspices. Finally, Dr Burns' daughter's achievement could not ultimately be tied to his donations. Her progress as a trainee depended solely on her physical skills and ability. If she was capable she would be chosen whether or not Dr Burns made any donations.

Thus the *Burns* decision contributes some important ideas to the Canadian case law. It puts the relevance of contract into perspective in determining whether or not there has been a gift. It promotes charitable motive as the main test. It rejects the proposition that the taxpayer's motive must be exclusively charitable, thus allowing for the co-existence of a primary charitable objective and a secondary personal objective. Finally, there was no suggestion in this case that the donation could be apportioned into personal and charitable components.

The donor benefit problem next arose in the *McBurney* case. The Federal Court Trial Division could have treated it as another religious school tuition case and, following *Zandstra*, apportioned the payments between a non-deductible fee for secular education and a deductible charitable gift. Instead, Mr Justice Muldoon distinguished *Zandstra* on factual grounds and allowed the full amount of the donation as a charitable deduction.[16] Although the Federal Court of Appeal recently overruled the Trial Division, it left unanswered some troublesome points raised in Muldoon J.'s decision.[17]

As the Federal Court of Appeal makes clear, *Zandstra* and *McBurney* are factually indistinguishable. The schools in both cases stressed Christian religious instruction over secular instruction. Parents contributed to each school according to their ability to pay. Those who could not pay were not pressured, and their children were neither denied admission nor expelled. In both cases the parents felt obligated by their sense of Christian duty to educate their children from a strictly religious perspective and this obligation formed the basis of a "clear understanding with the charities that while [their] children were attending these schools [the parents] would contribute within [their] means."[18]

An important part of the Federal Court of Appeal's decision is the affirmation of the test applied in *Zandstra*. In that case, Heald J., when he was sitting in the Federal Court Trial Division, adopted a definition of gift

[16]*McBurney* (T.D.), *supra*, note 4.
[17]*McBurney* (A.D.), *supra*, note 5.
[18]*McBurney* (A.D.), *ibid.* at 219 (C.T.C.), 5436 (D.T.C.).

from an Australian High Court case, *Commissioner of Taxation of Australia* v. *McPhail*.[19] Under the *McPhail* approach, a gift has two distinct requirements which must be separately tested. First, it cannot be a payment made pursuant to a contract. Second, the payment cannot result in the receipt of a material advantage.

The gifts in *McBurney* and *Zandstra* both run afoul of the second limb of the *McPhail* test. As was pointed out by the Federal Court of Appeal, Muldoon J. erred because he narrowed his inquiry to the first limb in *McPhail*.[20] He focused solely on "whether he [McBurney] paid tuition and received as *contractual consideration* the benefit of having his children receive a Christian education".[21] Relying on the evidence that the school neither attempted to collect unpaid pledges through legal measures, nor expelled children whose parents did not pay, Muldoon J. found there was no contractual obligation between the parents and the school and hence the full amount was a gift.

The Federal Court of Appeal puts the school tuition payment cases back on track. The importance of this cannot be overrated. There was already at least one lower court decision choosing to follow *McBurney* over *Zandstra*.[22]

The Federal Court of Appeal, however, does not deal directly with Muldoon J.'s challenge to the appropriateness of the second limb of the *McPhail* approach, the material benefit test. A major portion of Muldoon J.'s decision is a rejection of Revenue Canada's apportionment compromise. Intertwined with this rejection is his rejection of the material benefit test. It is useful to follow the logic of the Federal Court Trial Division, to uncover both its weaknesses as well as the legitimate questions it may raise.

---

[19](1968), 117 C.L.R. 111 at 116, 41 A.L.J.R. 346 [hereinafter *McPhail* cited to C.L.R.], quoted in *Zandstra*, *supra*, note 11 at 508 (C.T.C.), 6419 (D.T.C.):

> But it is, I think, clear that to constitute a "gift", it must appear that the property transferred was transferred voluntarily and not as the result of a contractual obligation to transfer it and that no advantage of a material character was received by the transferor by way of a return.

[20]*McBurney* (A.D.), *supra*, note 5 at 218 (C.T.C.), 5435 (D.T.C.).

[21]*McBurney* (T.D.), *supra*, note 4 at 474 (C.T.C.), 6501 (D.T.C.) [emphasis added]. Even with this narrow question, the *McBurney* facts should have presented real difficulties. Although the taxpayer alleged that no tuition fee was levied, the record is replete with references to tuition fees: in the information handbook, the corporation constitutions and by-laws, and even the school's first year statement of receipts and expenditures. The amounts originally designated tuition fees in the operating statements were, in later years, redesignated "donations from parents and students". Muldoon J., *supra* at 476 (C.T.C.), 6502-3 (D.T.C.), dismissed the references to tuition fees as "stressful semantics" finding that the school officials had simply changed the terminology to conform with its ideals, its practices and the reality of the matter. In contrast, the Federal Court of Appeal re-emphasizes the references to tuition in the record.

[22]*Bleeker Stereo and Television Ltd* v. *Minister of National Revenue* (1984), [1984] C.T.C. 2885, 84 D.T.C. 1761 (Tax Ct).

Although the Minister of National Revenue had not challenged the charitable status of the religious schools involved, Muldoon J. begins his decision with a lengthy, general discussion of the definition of charity and the importance of the advancement of religion in Canadian culture.[23]

He emphasizes that although churches provide their members with a variety of religious, educational and social benefits, donations to the church are *fully* tax deductible.

> It is worth emphasizing that according to the state of the law today, contributors to parish churches are rightly entitled to full income tax deductions, up to the prescribed limits, for their contributions even though they received the manifest and multifold benefits of their parish worship, instruction, pastoral services and counselling, year in and year out, for themselves and their children. ... There can be no doubt that the sermons and homilies, the Bible study groups and the Sunday schools, the adult counselling and marriage preparation courses can be characterized as both educational and religious, but nothing about that characterization entitles the Department of National Revenue to vivisect the parishioners' contributions for income tax purposes. Parliament has not authorized the Minister of National Revenue to do that.[24]

With this background, Muldoon J. begins to unravel Information Circular 75-23's compromise position with respect to payments to religious schools. Looking at the religious schools in the *McBurney* case, Muldoon J. concludes that, "[e]ach corporation, with the school it operates, is in law a religious charity and an educational charity."[25] He then draws an analogy between the religious schools in the case before him, and the parish church. The analogy is supported in two ways. First, he underscores the educational component in many church-based activities. Second, he quotes from the trial record to show that in these particular Christian schools, the religious perspective is so pervasive that, "[i]t was and is blended with [secular subjects] such that, if the secular and religious teachings were (to make an analogy) chemical elements, they would be combined in solution of varying proportions from hour to hour throughout the school year."[26]

Once the analogy between these religious schools and the parish church is accepted, it is a short logical leap to the proposition that Revenue Canada cannot "vivisect" payments to these religious schools without being discriminating.

> Thus it is not whether the plaintiff received *any benefit at all*, big or small, real or imaginary, physical or metaphysical, material or immaterial from, and as a result of, his monetary contributions to the three charities. So to pose the

---

[23]*McBurney* (T.D.), *supra*, note 4 at 468-69 (C.T.C.), 6496-97 (D.T.C.).
[24]*Ibid.* at 470 (C.T.C.), 6497-98 (D.T.C.).
[25]*Ibid.* at 472 (C.T.C.), 6500 (D.T.C.).
[26]*Ibid.* at 472 (C.T.C.), 6499 (D.T.C.).

> question would demonstrate an intent to treat the religious charities carried on by the three corporations differently from the treatment habitually and correctly accorded to those religious charities carried on by parishes and other religious congregations.[27]

Muldoon J.'s rejection of Revenue Canada's apportionment compromise is, in effect, a rejection of the material benefit test. If there is no authority to vivisect contributions to a parish church into non-deductible material benefits and deductible spiritual benefits, likewise there is no authority to vivisect contributions to religious schools. The judge therefore confined himself to ascertaining whether there was a contractual obligation to pay tuition.

If Muldoon J.'s reasoning had been allowed to stand, it would have been disastrous from a tax policy perspective.[28] In effect, by defining "gift" as merely the absence of a legal contract to pay tuition, it would have potentially enlarged the types of payments to charities which would be deductible, without requiring any examination of whether the payment was in reality a non-deductible personal expense. Muldoon J. emphasized the tax policy of promoting one particular charitable activity, namely the advancement of religion, without ever considering the countervailing tax policy that personal expenditures such as elementary school tuition are non-deductible.[29] Also, as an earlier case, *No. 688*, pointed out, a decision allowing a full deduction would promote schemes to camouflage tuition fees as donations.[30]

---

[27]*Ibid.* at 473 (C.T.C.), 6500 (D.T.C.).

[28]For an excellent critique of the trial decision, see G. Bale, "Construing a Taxing Statute or Tilting at Windmills: Charitable Donation Deduction and the Charter of Rights and Freedoms" (1985-86) 19 E.T.R. 37.

[29]*ITA* paras 60(e), (f) and (g) allow students attending certain secondary and post-secondary institutions to deduct tuition fees. Elementary school tuition is non-deductible under the general provisions of *ITA* para. 18(1)(h).

[30]In that case the Tax Appeal Board denied the taxpayer's deduction of contributions to the Associated Hebrew Schools of Toronto attended by his children. There was no tuition fee. Parents were encouraged to contribute according to their financial ability, although some contributed nothing. Only nominal amounts of $10 or $15 annually were contributed on behalf of 10 per cent of the 2,000 pupils enrolled. Undoubtedly, if the reasoning in *McBurney* (T.D.) were applied to the facts in *No. 688*, the parents in the latter case would have been allowed a full deduction.

The Board in *No. 688*, *supra*, note 12 at 406, accepted the argument proposed by the Minister of National Revenue, who had submitted that:

> shocking results might flow from the allowance of this appeal. It would mean that in order to obtain a deduction under Section 27(1)(a) of the *Income Tax Act* all that would have to be done would be for the various educational institutions to agree with the parents not to charge a fixed amount ... but to make a donation which could be deducted.

Muldoon J. cites two cases, *Antoine Guertin Ltée* v. *R.* and *Burns*, in support of his position that the receipt of a material benefit is not relevant for determining whether a gift has been made. *Antoine Guertin Ltée* v. *R.*[31] is cited as an instance where a charitable deduction was allowed despite the receipt by the donor of direct and quantifiable benefits. However, the case deals solely with *ITA* subsection 245(1). The Minister was challenging a series of interconnected employee bonuses, charitable deductions and loans as artificial transactions.[32] Because the Minister's assessment did not raise *ITA* paragraph 110(1)(a), the court never considered whether the charitable donations were truly gifts. Neither the ultimate holding nor the court's reasoning had any real bearing on the questions presented in *McBurney*.

The *Burns* case also provides weak support for the analysis applied in *McBurney*. First, the case specifically rejects using the absence of a contractual obligation as proof that a gift has been made. Although the judge quotes from counsel's arguments on whether "consideration" and "benefit" are synonymous, he does not give an opinion on the matter. Instead the case is resolved by finding that the taxpayer's motivation was primarily charitable, a point not even considered in *McBurney*.[33]

The Federal Court of Appeal decision in *McBurney* reaffirms the material benefit test of *McPhail* as applied in *Zandstra*. Unfortunately, the decision does not adequately discuss the critical question of how to identify a material benefit. It therefore does not answer Muldoon J.'s challenge that, since we do not vivisect donations to churches where the parishioners receive "benefits" such as Sunday school instruction or marriage counselling, we cannot vivisect donations to a church school where religion and education are inseparable. Furthermore, the decision does not provide a standard for analyzing more difficult benefit situations such as the one presented in *Burns*.

The Court of Appeal finds a material benefit on two independent grounds. First, the taxpayer made the donation out of a sense of personal obligation

---

[31](1981), [1981] C.T.C. 351, 81 D.T.C. 5045 (F.C.T.D.) [hereinafter *Antoine Guertin Ltée*].

[32]The taxpayer's employees were paid large year-end bonuses on the pre-arranged understanding that they would donate approximately one third to a specific charity. The charity then lent the donated amount back to the taxpayer at an interest rate significantly lower than the prevailing rate. In effect, the taxpayer reduced its taxable income by paying large employee bonuses, and avoided *ITA* para. 110(1)(a)'s limitation on charitable deduction to 20 per cent of income. It also maintained its level of working capital through the loan back at a favourable interest rate.

[33]In *dicta*, Taylor J. noted the lack of specific case law on the effect of a donor's personal involvement on the tax deductibility of a charitable gift. However, he did not purport to answer the difficult questions posed. *Burns*, *supra*, note 3 at 2634 (C.T.C.), 561 (D.T.C.).

or "Christian duty".[34] Second, the donation allowed the taxpayer to discharge his legal obligation to educate his children.[35]

The latter reason, although quite clear and specific, is a very narrow ground without much general application. On the other hand, the former ground is so broad that it provides no standard at all. It could literally apply to any donation to any charity where the taxpayer feels he has a personal or moral obligation to support the charity's objectives. It does not focus on the real crux of the matter. Mr McBurney's donations directly resulted in the private school education of his children. This is something we ordinarily expect to pay for and which is easily valued.

Perhaps the failure of the Federal Court of Appeal to articulate the meaning of "material benefits" stems from the patent nature of the benefit in *McBurney*. Unfortunately, the language used does not provide a basis for analyzing more borderline situations. The subsequent discussion in this paper on the application of a material benefit test will attempt to go much further in dealing with this question.

III. Problem Stated and Solntion Proposed

Since the charitable deduction is an exception to the general prohibition on the deductibility of personal expenses, it is not surprising that different tax policies collide at this point. There is no simple solution. On the one hand, we want to encourage contributions to further charitable activities. On the other hand, ordinary business transactions which happen to occur between a taxpayer and a charity should not change their tax status simply because one of the parties is a charity. Equity among taxpayers will not be preserved unless the deductibility of goods and services purchased from charities depends only on the general principles contained in the *Income Tax Act*. Payments which are actually non-deductible personal expenditures should be treated as such, and there should also be consistency in the treatment of business expenses. Furthermore, if a deduction results simply because the payee is a charity, it would give charities an unintended and unearned competitive edge in those areas where there are profit-making organizations providing similar services.

This paper attempts to formulate an analysis of charitable gifts which harmonizes the foregoing tax policies. The objective is to distinguish gifts from ordinary business or personal transactions, without inhibiting charitable giving. A three-pronged analysis using a combination of subjective and objective tests is proposed. The second test is the most effective one

[34] *McBurney* (A.D.), *supra*, note 5 at 219 (C.T.C.), 5436 (D.T.C.).
[35] *Ibid.* at 220 (C.T.C.), 5437 (D.T.C.).

for reconciling the inherent conflicts in tax policies. The first and third tests, however, supplement the second and prevent some otherwise inequitable results.

The first test evaluates the taxpayer's subjective intent. To qualify for the deduction, the taypayer must demonstrate that *one* of his or her significant reasons for the donation was to further the charity's public objective. The proposed test would disqualify the donation for a deduction only if the taxpayer's charitable objectives were insignificant or non-existent, or if his or her commercial expectations were overwhelmingly paramount.

While a subjective intent test has already been applied in some cases, they require the taxpayer to prove that his or her *dominant* motive was the furtherance of a charitable purpose. As will be discussed, the dominant motive requirement is not relevant to the tax policy behind encouraging charitable giving. Also, because taxpayers often have several motives for charitable giving, a dominant motive analysis easily leads to an artificial and unconvincing quantification and ranking of the taxpayer's subjective motives. For these reasons, the proposed subjective intent test is intended only as a relaxed threshold used to weed out purely commercial transactions which might pass the other two proposed tests.

The second test is objective: Did the contribution result in the taxpayer's direct or indirect receipt of an economic benefit? The test has two elements. There must be an economic benefit, as opposed to the general psychological benefits associated with giving. There must also be a causal connection, direct or indirect, between the benefit and the donation. As will be seen, this second test provides an objective approach to the conflict in tax policies inherent in disallowing deductions for personal expenditures while at the same time trying to encourage charitable giving through deductions. Also, in the context of this test it is possible to revive Revenue Canada's compromise position of apportioning contributions between a deductible charitable and a non-deductible personal or business element.

The third test is also objective. Regardless of the taxpayer's charitable motive, if for some reason the payment or transfer was compelled by statute, regnlation, court order or commercial contract, or to fulfill a precondition, then there has been no gift. This test has a limited scope. It is intended to catch non-voluntary transactions which slip through tests one and two.

The proposed tests have been suggested and shaped by Australian and American decisions in this area. Like Canada, the tax statutes of both these countries create an obvious point of tension by encouraging charitable giving through deductions and credits, while disallowing deductions for personal expenditures. Not suprisingly, the taxing authorities in both countries have had experience with taxpayer schemes to convert personal expenses into

charitable deductions. The Australian and American cases expose both the potential parameters of the problem and the shortcomings of different solutions which have been used.

One would expect that the natural backdrop to working on a solution to these donor benefit problems would be the common law definition of gift, such as that given in *Black's Law Dictionary*:

> A voluntary transfer of property to another made gratuitously and without consideration.[36]

However, both the Australian and American cases are clear that the word gift, as used in the taxing statutes, is not completely synonymous with the common law definition of gift.[37] In *DeJong* v. *Commissioner of Internal Revenue*,[38] the United States Court of Appeals, Ninth Circuit, adopted a "colloquial" definition of gift from an earlier United States Supreme Court decision. The Court refers to several situations which fit the common law definition of gift, but which do not mesh with the ordinary sense of the word as it is used in the taxing statute.

> The course of decision here makes it plain that the statute does not use the term "gift" in the common law sense, but in a more colloquial sense. This Court has indicated that a voluntary transfer of his property by one to another, without any consideration or compensation therefor, though a common-law gift, is not necessarily a "gift" within the meaning of the statute. For the Court has shown that the mere absence of a legal or moral obligation to make such a payment does not establish that it is a gift. ... And, importantly, if the payment proceeds primarily from "the incentive of anticipated benefits" of an economic nature, ... it is not a gift. And, conversely, "[w]here the payment is in return for services rendered, it is irrelevant that the donor derives no economic benefit from it".[39]

Several Canadian cases have implicitly acknowledged the imperfect fit between the common law definition of gift and the meaning of the word in the taxing statutes. In *Olympia Floor & Wall Tile (Quebec) Ltd* v. *Minister*

---

[36]*Black's Law Dictionary*, 5th ed. (St Paul, Minn.: West, 1979) at 619.

[37]In *McPhail*, *supra*, note 19 at 115-16, Owen J., relying on English authority, comments on the meaning of gift as used in the charitable deduction provisions of the Australian *Income Tax Assessment Act* 1936-1966:

> There is nothing in the Act which defines the word "gift" or which extends its ordinary meaning to cover a disposition of property in circumstances in which the disponor receives a benefit in return for the transfer of the property. ... The word as used in s. 78(1) is, I think, used in the sense in which it is understood in ordinary parlance.

[38]309 F.2d 373 (1962) [hereinafter *DeJong*].

[39]*Ibid.* at 377 citing from *Comm'r of Internal Revenue* v. *Duberstein*, 363 U.S. 278 (1960) [hereinafter *Duberstein*].

of National Revenue,[40] the taxpayer corporation deducted a portion of its contributions to charity as a business expense, rather than as a charitable donation. The charities involved were chosen by the taxpayer because they were directed by persons the taxpayer was cultivating as business customers. Jackett J. noted that some payments, although gifts in the sense that they were made without legal obligation, were still ordinary business transactions. He gave as an example employee bonuses, which under most circumstances, are ordinary business transactions and not gifts, despite the fact that there is no consideration. He noted that "good business can dictate ... disbursements over and above the amounts legally owing for what the business man has received or is to receive."[41] As previously discussed, the *Burns* decision also made it clear that the absence of a contractual obligation is not sufficient to prove that a gift has been made.

A. Test One: Subjective Intent

For the purposes of a taxing statute, we need a definition of gift which accurately distinguishes it from other transactions. The courts have found that the common law definition of gift places too much emphasis on the absence of a legal contract and on the absence of compulsion. Strictly applied, the common law definition may characterize some clearly commercial transactions as gifts. An employee bonus payment has the voluntary, non-compulsive, non-contractual elements of a common law gift, and yet it is undeniably an ordinary business payment.

What element makes the bonus payment a business expense rather than a gift? Some courts have pinpointed the taxpayer's motivation as the key distinction. Even if the bonus payment is motivated by the employer's good feelings towards the employee, the primary motivation is the expectation that it will promote employee morale and loyalty. Hence, a considerable number of cases have focused on subjective intent or taxpayer motivation to draw the line between a gift and other transactions.[42]

---

[40](1970), [1970] C.T.C. 99, 70 D.T.C. 6085 (Ex. Ct) [hereinafter *Olympia Floor*]. The main issue in *Olympia Floor* was whether the charitable deduction sections of the *Income Tax Act* precluded a deduction for such gifts under another statutory provision. That issue was resolved in the taxpayer's favour.

[41]*Olympia Floor, ibid.* at 106 (C.T.C.), 6089 (D.T.C.). Jackett J. is quoting from his own judgment in *Montreal Trust Co.* v. *Minister of National Revenue* (1966), [1966] C.T.C. 648 at 655, 66 D.T.C. 5424 at 5428 (Ex. Ct) [hereinafter *Crosbie Estate*].

[42]In the Canadian context, we see this most clearly in *Burns, supra*, note 3, where the pivotal consideration was the taxpayer's motivation for making the donation to the Canadian Ski Association.

In the United States, subjective intent was first used in the taxing area by the United States Supreme Court to distinguish gifts,[43] excluded from income by *Internal Revenue Code*, section 102, from other income receipts. Subsequently, the test was applied in *DeJong* by the Ninth Circuit Court of Appeals in the charitable donation context. The criteria for a gift was expressed as follows:

> A gift in the statutory sense, on the other hand, proceeds from a "detached and disinterested generosity," ... "out of affection, respect, admiration, charity or like impulses." ... "What controls is the intention with which payment, however voluntary, has been made."[44]

Against this, the Court juxtaposed "the constraining forces of any moral or legal duty" and "the incentive of anticipated benefit of an economic nature"[45] as motives which would not support a charitable gift deduction. Using this criteria, the taxpayer's contributions to schools attended by his children were held to be in the nature of tuition fees and not charitable gifts.

Delving into a taxpayer's subjective intent is always an uncomfortable proposition. Consequently, the appropriateness of the subjective intent test has been hotly debated among the various circuits of the United States Court of Appeals. The First Circuit rigorously rejected the *DeJong* test in *Crosby Valve & Gage Co.* v. *Commissioner of Internal Revenue*:

> Were the deductibility of a contribution under section 170(c) of the Internal Revenue Code of 1954 to depend on "detached and disinterested generosity", an important area of tax law would become a mare's nest of uncertainty woven of judicial value judgments irrelevant to eleemosynary reality. Community good will, the desire to avoid community bad will, public pressures of other kinds, tax avoidance, prestige, conscience-salving, a vindictive desire to prevent relatives from inheriting family wealth — these are only some of the motives which may lie close to the heart, or so-called heart, of one who gives to a charity. If the policy of the income tax laws favoring charitable contributions is to be effectively carried out, there is good reason to avoid unnecessary intrusions of subjective judgments as to what prompts the financial support of the organized but non-governmental good works of society.[46]

Because of this debate, as well as the greater variety of fact patterns litigated, the American cases provide good examples of the weaknesses of the subjective intent analysis. To begin with, the "detached generosity" language is not appropriate for a corporate taxpayer. Hence, soon after *DeJong*,

---

[43]*Duberstein, supra*, note 39.

[44]*DeJong, supra*, note 38 at 378 quoting *Duberstein, ibid.*

[45]*DeJong, ibid.* at 379.

[46]380 F.2d 146 at 146-47 (1967) [hereinafter *Crosby Valve*].

the Ninth Circuit Court of Appeals acknowledged in *United States* v. *Transamerica Corp.* that "[i]t does not seem appropriate, however, to demand of a corporate entity such impulses as affection, respect or admiration."[47]

At first blush, this attempt to restate the subjective intent test in order to fit the corporate taxpayer more accurately does not seem to change the fundamental inquiry, namely the dominant motive for the donation. In fact, it highlights an existing ambiguity as to the kind of proof required. Does the taxpayer have to prove a positive charitable state of mind or, as implied in *Transamerica*, is it sufficient to negate commercial intention? It is not surprising, therefore, that the subsequent American cases citing either *DeJong* or *Transamerica* start to waffle as to what factors prove or disprove the intent to make a charitable gift.

What motives destroy gift intention? If you require positive proof of a generous motive, then any form of compulsion should obviously disprove the gift element. This was the stance taken in *Perlmutter* v. *Commissioner of Internal Revenue*.[48] The taxpayer, a developer, in compliance with county regulations, dedicated a percentage of land in a new subdivision to the county for schools, parks and other facilities. The entire charitable deduction was denied partially because the taxpayer acted under the compulsion of legal requirements.[49]

With this precedent, one would expect other land dedication cases which involve donations of property in order to bring adjacent property into conformity with either local zoning requirements or under threat of condemnation, to likewise deny a charitable deduction because of a clear lack of charitable intent. However, even within the Ninth Circuit there is a considerable inconsistency. For instance, in *Collman* v. *Commissioner of Internal Revenue*,[50] the taxpayer, an individual, testified that his motive for dedicating a strip of land to the city was in part to avoid a future condemnation suit. The Court specifically noted that this purpose *did not* prevent a charitable

[47]392 F.2d 522 at 524 (1968) [hereinafter *Transamerica*]. The corporate taxpayer had claimed a charitable deduction for its donation of a strip of land to the City of Oakland for use as a street. The Court upheld the denial of a charitable deduction on the grounds that the sole purpose of the transfer was to obtain a direct economic benefit for the taxpayer.

[48]45 T.C. 311 (Tax Ct 1965) [hereinafter *Perlmutter*].

[49]This aspect of *Perlmutter* was later noted with approval in *Transamerica*, *supra*, note 47 at 524 n. 1.

[50]511 F.2d 1263 (9th Cir. 1975).

deduction.[51] Instead, the Court evaluated the Internal Revenue Service's evidence of business intention and found it to be insufficient. Thus, proof positive of charitable intention was found by showing lack of economic motivation, without regard to the taxpayer's statements indicating a non-charitable motive. This result seems at odds with *Perlmutter.*

Although the "disinterested generosity" language continues to be quoted, many American cases have switched to an analysis of what economic advantages were anticipated by the taxpayer. Thus, in *Stubbs* v. *United States*, another land dedication case, a slightly different standard emerges:

> The inquiry into motive and purpose here does more than probe the subjective attitude of the donors and the extent to which public spirited and charitable benevolence prompted their action. The inquiry serves to expose the true nature of the transaction: that, as the jury found, the "gift" (as in *DeJong*) was in expectation of the receipt of certain specific direct economic benefits within the power of the recipient to bestow directly or indirectly, which otherwise might not be forthcoming.[52]

This is still a subjective intent test. However, the emphasis has now clearly shifted to whether the taxpayer had economic expectations. The results are often inconsistent as different factors are considered relevant in each case. Thus, in *Sutton* v. *Commissioner of Internal Revenue*[53] the Court disallowed a charitable deduction because the taxpayer, a member of the City of Westminster Planning Commission, was presumed to be highly aware that his dedication of an easement for street widening purposes would lead, within a relatively short period of time, to increased saleability of his adjacent property. On the other hand, in *Allen* v. *United States*[54] a charitable deduction was granted to a developer who donated nine acres of redwoods in order to secure city approval of a zoning variance for his adjacent property.

Another problematic aspect of the subjective intent test is the unavoidable reliance on self-serving testimony. In *Dowell* v. *United States*[55] the taxpayer sought admission to a retirement village owned by a religious charity. Prior to applying, it was made clear to her that a monthly fee was charged to cover only the village's current operating expenses. The capital cost of constructing the living units was met by "sponsorship gifts" which

---

[51] *Ibid.* at 1269 n. 3. It is interesting to contrast *this* with the Tax Court of Canada's attempt, in *Burns, supra,* note 3 at 2632-33 (C.T.C.), 560 (D.T.C.), to weigh the relative importance of charitable versus personal motivation. Taylor J. looked for some positive evidence of the taxpayer's charitable interest. He found it in the taxpayer's personal history of involvement and support of the Canadian Ski Association's activities prior to his daughter's personal ski training.

[52] 428 F.2d 885 at 887 (9th Cir. 1970).

[53] 57 T.C. 239 (Tax Ct 1971) [hereinafter *Sutton*].

[54] 541 F.2d 786 (9th Cir. 1976) [hereinafter *Allen*].

[55] 553 F.2d 1233 (10th Cir. 1977) [hereinafter *Dowell*].

were "requested but not required" of all residents.[56] Two weeks after her application for admission was accepted, Dowell made a sponsorship gift of $22,500. She testified that "she made the 'sponsorship gift' because she wished to do so; she felt no duress to do so ... she made the gift out of charity and generosity knowing that her gift would help others; and she did not anticipate receiving any benefits from the gift nor did she expect that any part of the gift would ever be returned to her."[57] Although the Court agreed that a gift had been made,[58] with respect to the taxpayer's testimony, the Court made the following comments:

> We are cognizant that such testimony, subjective in nature and inclined to be self-serving in relation to the issue of intent, is suspect. ...
>
> We recognize that this argument "pinpoints" the obvious danger of placing substantial weight upon the subjective intent elicited by testimony of the donor, in light of the self-service urgence.[59]

Perhaps the most significant problem with a subjective intent test was pointed out in the passage already quoted from *Crosby Valve*.[60] A donor may have several motives for making a gift, some community minded, some family oriented, some business oriented. Some of the non-business motives may not be particularly altruistic. Where the motives are truly mixed, in addition to the difficulties encountered in the foregoing cases, the courts become embroiled in a further level of subjective analysis in attempting to discern the predominant motive. We see this most clearly in *Burns* where the Tax Court of Canada came up with a rather unconvincing factual analysis of the taxpayer's primary and secondary motives. In all likelihood, Dr Burns was equally motivated by his personal and non-personal considerations, but a standard which focuses on primary motivation inhibits this conclusion.

This discussion began with the idea that detached generosity, or lack of economic motive, is what distingnishes a gift from other transactions. The test is very seductive, as it strikes a chord of common sense. However, assuming that there are other ways to make the distinction, and given the problems illustrated, it is questionable whether it should be used in the context of a taxing statute.

Perhaps the question to be posed is as follows: How relevant is the taxpayer's motive to the tax policies behind the charitable deduction? The

---

[56]*Ibid.* at 1237.

[57]*Ibid.* at 1236-37.

[58]The evidence showed that more than 75 per cent of all residents made the sponsorship gift. Further, a majority of the residents who left were refunded a portion of their sponsorship gift. It is hard to imagine on what basis a charitable gift would be refunded, unless, of course, the gift had been made with the expectation of certain economic benefits which was not fulfilled.

[59]*Dowell, supra,* note 55 at 1238-39.

[60]See *supra,* note 46 and accompanying text.

purpose of the deduction is to facilitate the private funding of charitable activities. This purpose is restricted by principles of equity which dictate first, that a taxpayer's expenditures for goods and services should not be deductible merely because they are obtained from a charity. Second, charities providing goods and services should not be put in a competitively advantageous position vis-à-vis commercial providers of the same items. Since the taxing statutes are not concerned with elevating the moral character of the giver, the taxpayer's dominant state of mind becomes less relevant. These considerations have led several circuits of the United States Court of Appeals to reject subjective intent tests in favour of an objective, or *quid pro quo* test, under which "the issue is whether the transfer was 'to any substantial extent, offset by the cost of the services rendered to [the] taxpayers.'"[61]

This objective test strikes more directly at the heart of the problem.[62] From a tax policy perspective, what we want to ascertain is whether the contribution promotes the charitable activities without converting a payment for goods and services into a deductible item or creating inequities between charities and businesses.

Since the second proposed test isolates personal and business expenditures by analyzing the benefit received by the donor, is the subjective intent of the taxpayer relevant at all? Are there any situations where the economic benefit test will not exclude a clearly personal or business expenditure from the gift category? One particular type of situation does come to mind. If an expenditure were made with the expectation of an economic benefit, but for unforeseen reasons the benefit did not materialize, without a subjective intent analysis, the expenditure could be construed as a gift. For instance, suppose the taxpayer dedicated a strip of land for highway construction anticipating that this would increase the value of his or her adjacent property, and the market did not rise to meet these expectations. An objective analysis measuring the benefit received would not prevent the charitable deduction. On the other hand, an intent test would characterize this gift as non-charitable.[63]

Is there a way to frame a subjective intent test so as to avoid an analysis of primary and secondary motives, reduce reliance on self-serving testimony, reduce the inconsistencies in both the standards applied and the proof required, and still prevent an obvious business transaction from slipping through as

[61] *Haak* v. *United States*, 451 F. Supp. 1087 at 1090 (W.D. Mich. 1978), quoting from *Oppewal*, *infra*, note 72 at 1002.

[62] As will be discussed more fully later, the American objective test is slightly different than the third test proposed by this article, *i.e.*, does the contribution result in the taxpayer's direct or indirect receipt of an economic benefit? See *infra*, Part III.C.

[63] See R.D. Hobbet, "Charitable Contributions — How Charitable Must They Be?" (1980) 11 Seton Hall L. Rev. 1 at 15, where the author argues for a purely subjective intent test in part because it would easily resolve situations such as the one discussed.

a charitable deduction? The subjective intent test as previously applied in case law requires charity to be the taxpayer's *primary* motive. The solution proposed here is to lower the standard and require instead that *one* of the taxpayer's *significant* motives be charitable. Then in most situations where there are mixed motives, the taxpayer will easily pass the subjective intent test. Any non-gift element can then be further scrutinized under the second objective test, and, as will be seen, the possibility of apportioning the contribution then arises. The proposed subjective intent test will only deny a charitable deduction where the taxpayer was motivated almost solely by hopes of a business advantage. The test still requires some ranking of motives. However, because the test allows for more than one significant motive, the level of subjective analysis is reduced. The results of the test should thus be less artificial and more convincing.

B. Test Two: Economic Benefit

This second test is derived from the Australian High Court case of *McPhail*. A charitable deduction shall be disallowed to the extent that the taxpayer received a direct or indirect economic benefit as a result of the contribution. In this test, the actual outcome of the payment is objectively evaluated rather than the intention or expectation of the taxpayer. Although the test includes indirect benefits, there must still be a causal link between the contribution and the benefit.

By measuring the benefit received, the personal or business element of a transaction is factually isolated. The charitable deduction may then be disallowed either entirely or partially, depending on the circumstances. Thus, the test puts in concrete form the countervailing tax policies which should properly restrict the scope of the charitable deduction to its charitable element. The test prevents the otherwise inequitable conversion of a personal or business expenditure into a charitable deduction.

At the same time, this test is potentially more generous to a taxpayer with mixed motives than is the dominant motive test. As long as the taxpayer can demonstrate a charitable motive sufficient to pass the lowered threshold in the proposed subjective intent test, he or she can justify allocating at least a portion of the payment to a charitable deduction. In contrast, under a pure dominant motive test, if the court decides that the predominant motive is non-charitable, no matter how significant the charitable element, no deduction should theoretically be allowed.[64]

[64]Several of the American cases which applied a subjective intent test apportioned the contribution without attempting to state any rationale. See, *e.g.*, *DeJong*, *supra*, note 38.

The proposed second test is consistent with the human reality that charitable gifts stem from mixed motives and have mixed effects. It neither penalizes the taxpayer because of the personal or business element, nor provides an unfair advantage or incentive to camouflage personal or business expenditures as charitable deductions. The test incorporates the essence of the Revenue Canada compromise approach in Information Circular 75-23 and Interpretation Bulletin IT-110R discussed earlier.

As with any test, the proposed benefit test raises several important issues and has certain weaknesses. Although the test accurately reflects important tax policies, it still requires the court to analyze issues such as the types of economic benefits which must be measured and the factors which are appropriate for determining whether the benefit is in fact sufficiently connected to the contribution. These issues will inevitably fall within the realm of judicial interpretation. As well, there are issues involving administrative convenience, such as the valuation of benefits and the effect of the test on the burden of proof. Before discussing these aspects directly, it is useful to examine the American and Australian cases which have evolved "objective" tests.

Disenchantment with the subjective intent test has led some American courts and the Internal Revenue Service through its Revenue Rulings to attempt to define an objective test. Two, or possibly three, objective tests have emerged, each based in part on an analysis of the benefit received by the taxpayer. However, for the most part, either in their formulation or application, these objective tests ultimately end up as subjective intent tests.

The earliest form of an objective test was proposed by the United States Court of Claims in *Singer Co.* v. *United States*.[65] Singer sewing machines were routinely sold at substantial discounts to two types of charities, schools for use in sewing classes and other charities such as churches and Red Cross groups. At issue was whether the discount to either category of charity qualified as a charitable deduction. Because of the controversy in the circuits on the appropriateness of the "disinterested generosity test", the Court in *Singer* derives its own test:

> It is our opinion that if the benefits received, or expected to be received, are substantial, and meaning by that, benefits greater than those that inure to the general public from transfers for charitable purposes, (which benefits are merely *incidental* to the transfer), then in such cases we feel the transferor has received, or expects to receive, a *quid pro quo* sufficient to remove the transfer from the realm of deductibility under section 170.[66]

[65]449 F.2d 413 (1971) [hereinafter *Singer*].
[66]*Ibid.* at 423.

Ostensibly, the *Singer* test is objective since it requires an analysis of benefits. However, because the test evaluates not only the benefits actually received, but also benefits "expected to be received", the inquiry inevitably shifted back to an examination of the taxpayer's intent.

The Court of Claims considered the discount sales to schools separately from those to other charities. As a preliminary point, it appropriately rejected Singer's argument that only a direct benefit should disqualify a charitable gift. However, there was no concrete evidence that Singer had received any particular indirect benefit.[67] In fact, Singer had attempted to negate any such inference by introducing a survey showing that only 1.735 per cent of purchasers had been influenced in their choice of machine by training on Singer machines. The survey, along with some other objective evidence, was given little, if any, weight. Instead, focusing on the "benefit expected" aspect of its test, the Court of Claims naturally resorted to a determination of the predominant purpose of the discounted sales. With respect to the discount sales to schools, the Court found the predominant purpose to be the enlargement of its future potential market by developing an interest in the Singer brand among young women trained on Singer machines.[68]

In contrast, with respect to the sales to other charities the Court found the primary purpose to be assistance to the charities in the performance of the charitable, religious or public services that they were currently providing. Creating a favourable public image was only an incidental effect.[69]

Thus, in the end, the objective aspect of the test becomes incorporated into a predominant purpose or subjective intent test. For this reason, it has been described as a hybrid objective/subjective test.[70]

Another difficulty with the *Singer* test is that it requires a comparison between the benefit to the donor and the benefit to the general public. The difficulty of measuring the benefit to the donor exists in any benefit test, and will be discussed subsequently. Suffice it to say that most of these problems can be dealt with by using standard valuation methods with which courts are familiar. The more difficult and interesting question in applying the *Singer* test is the measure of the benefit to the general public. Is it sufficient to equate that benefit with the fair market value of the gift, or

[67]If the receipt of an indirect benefit had been proven, using the Court of Claims' own test, the Court would then have had to compare the benefit accruing to Singer with the benefit accruing to the general public. For a critique of this aspect of the *Singer* test, see Hobbet, *supra*, note 63 at 6-8.

[68]*Supra*, note 65 at 423.

[69]*Ibid.* at 424.

[70]Hobbet, *supra*, note 63 at 6.

should other intangible factors be relevant, such as the value of relief provided to a disadvantaged group or the value of allowing a program to continue? These questions have not been dealt with by any court applying *Singer*.[71]

A more distinct benefit test was stated by the First Circuit Court of Appeals in *Oppewal* v. *Commissioner of Internal Revenue*,[72] another school tuition case. As in *DeJong* and *McBurney*, the religious schools involved in *Oppewal* relied on voluntary contributions rather than specific tuition fees, and students whose parents failed to make the suggested contributions were not denied admission or re-admission. Rejecting the subjective intent test the Court stated its test as follows:

> The more fundamental objective test is — however the payment was designated, and whatever motives the taxpayers had in making it, was it, to any substantial extent, offset by the cost of services rendered to the taxpayers in the nature of tuition? If so, payment, to the extent of the offset, should be regarded as tuition for, in substance, it served the same function as tuition.[73]

The test is straightforward. The offsetting benefit is measured, and to that extent the amount of the charitable gift is reduced. The *Oppewal* test differs from the proposed test in two ways. First, it does not expressly include indirect benefits which could be substantial. Second, because of the clear facts from which it emerges, the test assumes that there is a relationship between the contribution and the offsetting benefit. The test does not emphasize that the benefit to the taxpayer must be the result of the contribution and not the result of some other factors.

These shortcomings in the *Oppewal* test could easily have been dealt with as it became applied to subsequent fact patterns. However, a second version of the test emerged in Revenue Rulings and case law, which has overshadowed it. *Haak* v. *United States*, yet another school tuition case, states the objective test as follows:

> [I]f a transfer is made with the *expectation of receiving a benefit*, and such benefit is received, the transfer is not a charitable contribution under 26 U.S.C. § 170.[74]

---

[71]See, generally, *ibid.* at 6-8.

[72]468 F.2d 1000 (1972) [hereinafter *Oppewal*]. See also *Winters* v. *Comm'r of Internal Revenue*, 468 F.2d 778 (2d Cir. 1972), a school tuition case where the court applied both the subjective intent test of *DeJong*, *supra*, note 38 and the objective intent test of *Oppewal*.

[73]*Oppewal*, *ibid.* at 1002.

[74]*Supra*, note 61 at 1092 [emphasis added].

In Revenue Rulings the test has become:

> A contribution for purposes of section 170 of the Code is a voluntary transfer of money or property that is made *with no expectation of* procuring a financial benefit commensurate with the amount of the transfer.[75]

Although these tests require an objective analysis of benefits, they contain the problematic phrases "expectation of receiving" and "expectation of procuring". Like *Singer* they are thus susceptible to becoming subjective intent tests.

The impetus for including economic expectation in these tests is understandable. Because only the bald result is considered in a pure benefit-received test, it would be possible for a business transaction which failed to achieve its economic ends to qualify as a charitable deduction. The Court of Claims in *Singer* was particularly concerned with this point.[76] For this reason the proposed three-tiered test includes a modified subjective intent test in addition to a pure benefit test. The problem with the tests stated in *Singer, Haak* and the Revenue Rulings is that they try to cover the entire ground in a single statement. The clarity and impact of a benefit analysis becomes muddled and perhaps lost altogether. By keeping the subjective intent test and the benefit test separate and narrow, the domain and effect of each remains clear.

The Australian "*McPhail* rule" is the basic model for the proposed benefit test. It was first enunciated in the *McPhail* case by Owen J. sitting as a single judge for the High Court of Australia. For purposes of the income tax charitable deduction, a gift has to satisfy two distinct tests. First, it has to be a voluntary transfer and not as a result of a contract obligation. This aspect of the *McPhail* rule will be considered in a subsequent section. Second, the transferor cannot receive an advantage of a material character by way of return.[77]

In *McPhail*, a private boys school faced with having to increase tuition fees, devised a plan to lessen the financial burden on parents by turning a portion of the tuition fee into a tax deductible donation. Two fee schedules were sent out. Schedule A gave the normal fee which incorporated a special building fund charge. Schedule G listed a reduced tuition fee which, at the School Council's discretion, would be made available to applicants who committed themselves to a specific contribution to the building fund. The specific contribution was intended to be tax deductible. The difference between the tuition fees in Schedule A and Schedule G was almost the precise amount

---

[75]Rev. Rul. 83-104, 1983-2 C.B. 46; Rev. Rul. 76-185, 1976-1 C.B. 60 [emphasis added].

[76]*Supra*, note 65 at 420-21.

[77]*McPhail, supra*, note 19 at 116.

of the requested building fund contribution. On these facts it was easy for Owen J. to find that the substantial concession in the fees charged under Schedule G was a benefit directly resulting from the contribution. As will be discussed subsequently, Owen J. also held that there was a contract.

The Australian cases generally analyze charitable gifts using both tests of the *McPhail* rule. Many of the cases first construe the existence of a contract and then fortify the denial of the charitable deduction with the finding that a benefit was received. For instance, in *Case E44*,[78] a Taxation Board of Review case, the taxpayer, upon her acceptance as a resident in a housing unit run by the War Widows' Guild, made a $4,100 "donation" requested by the Guild. In conformity with requirements of a government subsidizing agency, there could be no written contract between the Guild and an applicant for housing. The subsidizing agency was trying to prevent a resident from claiming any implied or express property rights in the housing unit assigned. The Taxation Board of Review found first, that a contract existed and second, that

> [a]t the very least, even if no enforceable contract came into existence, the taxpayer, in return for the payment of $4,100, received a right of real value — the right to occupy a home unit for life on terms agreed to between the parties.[79]

As in *McPhail*, it was easy for the Board to enunciate the economic benefit received by the taxpayer, and the direct connection between the benefit and the contribution.

Cyprus Mines Corp. v. *Federal Commissioner of Taxation*[80] represents a more interesting application of the benefit test. An agreement between joint venturers in a mining operation and the State of Western Australia gave the joint venturers the option of substituting a gift to any Western Australian charitable fund, in lieu of certain royalty payments due under the contract. The joint venturer paid the required amount to the Western Australia Library Fund. Applying *McPhail*, the Supreme Court of Western Australia denied the deduction under both the contract and benefit tests. The benefit flowing to the taxpayer was the discharge of its liability to the State. The taxpayer had argued that only a benefit coming directly from the charity, in this case the Library Fund, should taint a gift under the benefit test. This argument was rejected, thus expanding the *McPhail* rule to direct and indirect benefits.

The issue of direct and indirect benefits was examined again in *Leary* v. *Federal Commissioner of Taxation*[81] by the Federal Court of Australia.

---

[78](1973), 73 A.T.C. 371.

[79]*Ibid.* at 372.

[80](1978), 22 A.L.R. 322 (S.C. W. Aust.) [hereinafter *Cyprus Mines*].

[81](1980), 32 A.L.R. 221 [hereinafter *Leary*].

The case is a fascinating example of a tax avoidance scheme involving charitable deductions. In simplified form, the facts were as follows. The Order of St John, a public benevolent institution under the Australian *Income Tax Assessment Act*, was approached by Metropolitan Taxation Service (MTS) with a fund-raising proposal. MTS would procure donations for the charity for a fee of 98.8 per cent of all monies raised. Although the charity only received 1.2 per cent of the donations, MTS guaranteed it a minimum of $100,000 annually, net of the fees to MTS. To meet this guarantee, MTS would have to raise in excess of $8,300,000.

MTS then sought potential donors by approaching various accountants and tax advisors. Leary, the taxpayer whose donation was at issue, became involved at the recommendation of his accountant. MTS, through a subsidiary, Sadar Finances (Sadar), lent Leary $8,500 at 5 per cent for a 40 year term. The loan agreement gave Leary several repayment options. Under one of these, Leary could buy back his $8,500 obligation to Sadar for a nominal $17, if he made a $10,000 donation to the Order of St John. The day following the loan by Sadar to Leary, Leary donated the $10,000 to the Order of St John and exercised his repurchase option.

The Order of St John retained $120 of the $10,000 donation. The remaining $9,880 fee paid to MTS represented $1,300 in profit for one day's use of its subsidiary's money, and $8,550 in return of capital to be redirected, one way or another, to Sadar. Leary claimed a tax deduction of $10,000 although his total outlay was only $1,500 plus the $17 paid to Sadar to discharge the loan. If the scheme were fully operative, it was estimated that the total tax relief provided to persons such as Leary would be $3,000,000.

The material advantage to Leary was the discharge of his $8,500 liability to Sadar for the nominal $17 payment. The benefit did not come directly from the Order of St John, so that the Court had to find a link between the payment to the Order and Sadar's willingness to extinguish the debt. Although the mechanics were not clear, it was evident that the Order of St John "fed" back to Sadar, via MTS, the funds required to economically justify the collapse of the loan.[82] Thus, the Court found the Order of St John was still the ultimate source of the material advantage.

These American and Australian cases provide a background for the discussion of the proposed benefit test which disallows a deduction to the extent that the taxpayer receives a direct or indirect economic benefit as a result of the contribution. This test is more straightforward and clearly objective than the American tests which have subjective intent elements incorporated into them. It has the advantage of harmonizing the conflict

[82]*Ibid.* at 231.

between the specific tax policy of promoting private funding of charitable activities and the general tax policies of disallowing deductions for personal expenses and requiring similar business expenses to be treated in the same way.

In applying this test, it is helpful to pose two distinct questions. First, to what extent did the taxpayer receive an economic benefit concomitant with the contribution? Second, was this economic benefit the result, directly or indirectly, of the contribution?

The first question requires a simple identification and quantification of the economic benefit to the taxpayer. To some extent it necessarily begs the second question by initially analyzing any benefits to the taxpayer without paying attention to the nexus between the benefit and the contribution.[83]

Leaving the nexus question aside, what is included in the scope of "economic benefit"? In broad, simplistic terms we are distinguishing between material benefit and the "psychic benefit" which "reflects only the general feeling of satisfaction which could result from making a donation".[84] Most benefits are straightforward and easy to categorize. There are, however, some conceptual points which should be dealt with first.

Many of the cases use the term *quid pro quo* or consideration to describe the quality of an offending economic benefit. Although these terms are used in a non-technical, almost metaphorical sense, they have the disadvantage of conjuring up contract requirements which are clearly not intended. For instance, the word "consideration" is used in *Zandstra* to describe the benefit of Christian education for the taxpayers' children.[85] Since *Zandstra* was applying the *McPhail* rule which has both a benefit and a contract test, the judge clearly did not intend the existence of a benefit to turn on whether a formal contractual relationship existed.

Economic benefit should not be treated as synonymous with contractual obligation. On the one hand, if the court looks at contract factors as opposed to whether the taxpayer has gained something of value, the definition of economic benefit becomes too narrow. On the other hand, just because the contribution is made to fulfill a contract provision does not necessarily mean

[83]This separation of the issues is somewhat strained and artificial, but it proves useful for discussion purposes. As will be seen, the nexus issue is really the more difficult of the two. It is also the question most dependent on the exercise of judicial discretion.

[84]*Burns, supra*, note 3 at 2631 (C.T.C.), 558 (D.T.C.).

[85]*Supra*, note 11 at 508 (C.T.C.), 6419 (D.T.C.).

that an economic benefit has resulted. A simple example of this was pointed out by Bowen C.J. in *Leary*:

> Thus, where A and B agreed to make gifts to C ... or A agreed with B to match any gift made to him by C, there would seem to be no reason why either A or B should be deprived of his deduction.[86]

For purposes of the benefit test, the inquiry should be confined to whether the taxpayer *received* something of economic value, apart from whether the right to receive it arose under a contract.

Whether a benefit exists should also not be confused with the question of whether it is easy or difficult to measure the benefit. These are problems which have administrative solutions.

Closely related to the difficulty of measuring a benefit is the question of benefits which are insubstantial. The tests in both *Singer* and *Oppewal* refer to "substantial benefits". Although the proposed test has not adopted this language, considering the general judicial disdain for trivial matters, it would certainly be expected that some *de minimus* threshold would emerge.[87]

The nexus issue is the most difficult and the weakest aspect of the benefit test in that it will undoubtedly turn on specific facts and circumstances and could thus lead to inconsistent results. The first difficulty comes from the inclusion of indirect benefits within the test's ambit. Any time the economic benefit comes not from the charity, but from a third party, or from surrounding circumstances not directly controlled by the charity, the issue of indirect benefits arises. We saw examples of these two types of indirect benefits in both the American and Australian cases: in *Leary*, where the charitable contribution led to the discharge of a debt to a third party, and in *Singer*, where the economic benefit was an increase in potential future sales, in other words, goodwill.

The second difficulty stems from the inherent vagueness of any causation test. Different fact situations suggest different approaches to establishing whether a nexus exists. In some instances, deciding whether the contribution was an integral part of a chain of events leading to a benefit might be appropriate. Other situations might justify a "but for" test: But for the contribution or contributions of a class of persons, would the benefit have been received?

---

[86]*Supra*, note 81 at 223.

[87]There are two possible administrative approaches. A simple approach would disregard benefits under a minimum dollar value. A more difficult approach would exempt benefits which represent less than a certain percentage of the total gift. Ideally, again, this would best be dealt with on an administrative level.

By applying the proposed benefit test to specific examples from cases and Revenue Rulings the specific problems relating to the scope of benefits, nexus and measurement can be considered and solutions proposed. For convenience of discusssion, economic benefits are broken down into four categories: (1) benefits in the nature of services rendered to the taxpayer; (2) benefits resulting in an increase in value of the donor's property; (3) receipt by the donor of property or a property right; and (4) miscellaneous, indirect and intangible benefits.

1. Services

Benefits in this category are the easiest to identify and to measure. The most typical example is the purchase of tickets to a charity-sponsored fund-raising performance or other event. To the extent that the price paid exceeds the ordinary price of a similar event, a charitable contribution could be justified. It is the taxpayer's burden to show the amount of the contribution and consequently his or her burden to prove the ordinary price of admission. For certain types of events, such as concerts, this should be easy. Other events, such as dinner dances, would be more difficult. An American author suggests that for these types of situations there should be a presumption that the benefit conferred is equal to the price of admission.[88] This is desirable from an administrative perspective and would probably also encourage the charities themselves to clearly state the amount of the gift being solicited.

Another typical situation was presented in Revenue Ruling 76-232.[89] The taxpayer attended marriage counselling seminars conducted by a charitable organization. Although there was no enrollment fee, at the conclusion of the seminar the charity requested a voluntary suggested contribution to cover the program's costs. Unlike the charity event, the payment was not a prerequisite to admission, so that the connection between the contribution and receipt of services was less straightforward. Without discussing the nexus issue, the Revenue Ruling merely applies a presumption that the taxpayer's payment was equal to the value received and denies the charitable deduction. The Revenue Ruling in essence assumes a connection between the benefit and the payment. Under the proposed benefit test it would have been easy to justify treating the payment as a reimbursement to the charity for services provided. Factors which connect the benefit and payment are

[88]Hobbet, *supra*, note 63 at 20-21.

[89]Rev. Rul. 76-232, 1976-1 C.B. 62. This Revenue Ruling creates an interesting contrast to Muldoon J.'s presumption in *McBurney* (T.D.), *supra*, note 4 at 470, that counselling services offered by the church should not affect the deductibility of donations. See also *Feistman* v. *Comm'r of Internal Revenue*, 1971 T.C.M. (P-H) ¶ 71, 137 (U.S. Tax Ct 1971) denying a deduction for dues to a Jewish synagogue because the taxpayer did not allocate the contribution between a charitable gift and payments entitling him to participate in social events.

the proximity in time between the seminar and the donation, the relationship between the requested amount and the cost of the services, and the absence of any other charge.

The same nexus issue emerges in the school tuition cases which invariably involve schools dedicated to educating the taxpayer's children regardless of whether he or she has made the full suggested contribution. The American cases which have used an objective approach have assumed an obvious connection between the contribution and the educational services provided. Recently, in Revenue Ruling 83-104,[90] the Internal Revenue Service attempted to formulate criteria for distinguishing disguised tuition payments from actual charitable contributions. The factors considered relevant all probe the nexus issue.

Revenue Ruling 83-104 treats certain factors which show a direct, implicit connection between the contribution and the educational services, as creating a presumption that the payment was not a charitable contribution. These factors are as follows:

> the existence of a contract under which a taxpayer agrees to make a "contribution" and which contains provisions ensuring the admission of the taxpayer's child; a plan allowing taxpayers either to pay tuition or to make "contributions" in exchange for schooling; the earmarking of a contribution for the direct benefit of a particular individual; or the otherwise-unexplained denial of admission or readmission to a school of children of taxpayers who are financially able, but do not contribute.[91]

If these factors are not present, the Revenue Ruling then looks to other economic and non-economic facts and circumstances tending to show a connection. Examples of factors which may themselves, or in combination, negate a charitable contribution are given:

> The factors that the service ordinarily will take into consideration, but will not limit itself to, are the following: (1) the absence of a significant tuition charge; (2) substantial or unusual pressure to contribute applied to parents of children attending a school; (3) contribution appeals made as part of the admission or enrollment process; (4) the absence of significant potential sources of revenue for operating the school other than contributions by parents of children attending the school; (5) another factor suggesting that a contribution policy has been created as a means of avoiding the characterization of payment as tuition.[92]

The Canadian cases, *Aspinall, Zandstra, McBurney* and *Burns*, fit within the service category. Under the proposed benefit test, the results in *Aspinall*, upholding a deduction for that portion of the ticket price for a charity-sponsored event which exceeds the ordinary cost of a ticket, would remain

---

[90]Rev. Rul. 83-104, *supra*, note 75.
[91]*Ibid.*
[92]*Ibid.*

the same. Likewise, *Zandstra* and *McBurney* epitomize the benefit test by approving charitable deductions only for the amount of the donation to the school in excess of the per pupil cost.

The most difficult case is *Burns*, which allowed the deduction for contributions to the Canadian Ski Association, despite the concurrent training of the taxpayer's daughter. The benefit in *Burns*, ski training, is identifiable and could be given a value based on the cost of private instruction. The issue in *Burns* would be the nexus between the contribution and the services. The type of analysis suggested by Revenue Ruling 83-104 provides an interesting approach.[93] First, there are no factors implying a direct connection, and hence no presumption would arise. As for indirect factors, no doubt the significant pressure on parents to contribute would be considered. However, the combination of independent, non-financial criteria for accepting a student in the training program, and the overwhelming public source of funding for the program as opposed to funding coming from a small class of persons with concurrent interests, would indicate a weak connection and negate the nexus between the contribution and benefit. Hence, arguably, *Burns* could withstand a benefit test.

2. Increase in Value of Taxpayer's Property

The primary example of this type of benefit is seen in the various American land dedication cases. Two typical situations occur. Real property is donated to local governments for highways, or as open space, to comply with requirements for changes in zoning. The taxpayer benefits by the increase in value of his or her property located in the vicinity. For example, in *Sutton*,[94] following the dedication of land for street widening purposes, the taxpayer's adjoining property became available for more lucrative commercial use. This increase in value is a measurable benefit which would offset the value of the donation in whole or in part. Courts and tax departments are familiar with this kind of valuation problem so that from an administrative perspective this approach is sound.

Facts and circumstances may dictate another result. *Citizens & Southern National Bank of South Carolina* v. *United States*[95] is an example of a case

[93]The Revenue Ruling applies its suggested factors to several hypothetical situations. Example no. 6 suggests an approach to *Burns*. The example proposes a church school funded directly by the church out of its general funds. Parents make up a minority of the church membership, and do not contribute more than non-parents to the general church funds. The example looks behind the school's financial structure to determine whether there is public or community support. Because public support is great, the connection between the parents' donation to the church and the benefit of education is weak, so that a deduction is justified.

[94]*Supra*, note 53.

[95]243 F. Supp. 900 (W.D. S.C. 1965).

where there may be several grounds for not finding an economic benefit. The Bank had recently located in a blighted urban area. To facilitate rejuvenation of the area, the Bank donated property for a highway which would bring the area within a business loop. Undoubtedly, the Bank benefitted by the increased business resulting from the area's revitalization. This is an indirect benefit and, therefore, within the benefit test's ambit. However, unlike an increase in fair market value of adjoining land from a change in zoning, it would be too difficult to attribute to what extent the increase in business resulted from the construction of the highway given the Bank's other promotional activities. Also the benefit might be characterized as *de minimus.*

3. Receipt of Property or a Property Right

A simple example of this type of economic benefit is illustrated by Revenue Ruling 76-185.[96] The taxpayer undertook to restore a state-owned historic mansion. Upon completion, the taxpayer was to have a non-assignable right to reside on the premises for 15 years, during which time he was to maintain the premises and grounds according to state specifications. There would be public access to the grounds on specified terms. The taxpayer sought treatment of the restoration expenses as a charitable donation. Clearly, the restoration was done in exchange for a valuable property right, the right of occupancy, which is easily measured.

Another more common situation falling within this category of benefit is where the taxpayer is admitted to a retirement or health care facility concurrently with a donation to the facility. The property right received by the taxpayer is the right to occupy a unit for life. The value of the benefit would be reduced to some extent by any additional monthly or annual charges paid. This was the approach taken by the Australian Board of Review in *Case E44.*[97]

These cases could, however, present nexus issues similar to those encountered in the school tuition cases. For instance, if the taxpayer could show that the institutions involved have broad-based public support or that

[96]Rev. Rul. 76-185, 1976-1 C.B. 60.
[97]*Supra,* note 78.

only a small percentage of persons admitted made any contribution, the link between the contribution and the benefit would be considerably weakened.[98]

4. Miscellaneous, Indirect, Intangible Benefits

The final category of benefits is a catch-all, and presents several difficult problems. First, when the benefit comes from a third party, rather than from the charity involved, the nexus between the contribution and the benefit will often be at issue. An example of this is seen in *Leary* where, as a result of a $10,000 charitable donation, the taxpayer acquired the right to discharge a loan to a third party for a nominal amount. Although there was a clear contractual connection between the contribution and the economic benefit, the Australian Federal Court was not content with this as a basis for disallowing the deduction. Instead, it focused on the fact that most of the funds paid to the charity ultimately found their way back to the third party, or to the third party's parent company. In other words, but for the recycling of the charitable donation, the third party could not have agreed to collapse the loan.[99]

To illustrate the importance of an economic nexus, as opposed to the simple contractual nexus, consider the following hypothetical. Two friends, A and B, agree that if A makes a $10,000 contribution to charity X, B will purchase A's house at a fair price. Although there is a cause and effect relationship between the contribution and the benefit to A, there is no economic connection. The benefit to A is not financially interrelated to the charitable contribution. Under this circumstance, a court would be validly reluctant to deny a charitable deduction under a benefit test.[100]

---

[98]An interesting case to reconsider would be *Dowell, supra,* note 55. The decision allowing the $22,500 charitable deduction emphasized the fact that the taxpayer had paid the suggested contribution two weeks *after* her formal acceptance by the retirement village. This is an example of confusing an analysis of benefit with formal contract requirements. However, the evidence showed that more than 60 per cent of the persons leaving the retirement village were reimbursed part of their contribution, a high percentage of persons admitted contributed the suggested amount and the monthly fees covered only the facility's daily operational as opposed to capital costs. These factors provide clear evidence of a connection between the contribution and the taxpayer's admission to the facility. Contrast *Dowell* with *Sedam* v. *United States,* 518 F.2d 242 (7th Cir. 1975), which disallowed a deduction for a "Founder's Gift" to a retirement home.

[99]*Leary, supra,* note 81 at 223.

[100]The Australian case, *Cyprus Mines, supra,* note 80, is similar to the hypothetical. The taxpayer had the option of either paying a royalty to the State of Western Australia or paying the same amount as a donation to a Western Australian charity. The benefit, the discharge of an obligation, was the direct result under the contract of the payment to the charity. What may be missing, however, is a clear economic connection, and hence this type of transaction may succeed under an economic benefit test. There are, in fact, good policy reasons for disallowing a deduction in the *Cyprus Mines* case. If the State of Western Australia were an individual taxpaying entity and it wanted to see part of the proceeds of a particular sale dedicated to

The *Singer* case raises the thorny problem of economic goodwill which might result from a charitable contribution. From the Court of Claims' perspective, Singer's discount sale of sewing machines to schools potentially created a market for Singer products among the students trained on them. At first blush, this type of economic goodwill seems like an obvious category of economic benefit. There are, however, several justifications for disregarding it.

Expenditures which create goodwill are increasingly being viewed as currently deductible business expenses.[101] In most instances, it would be to the taxpayer's advantage to characterize a payment as a business expense rather than as a charitable donation in order to avoid the percentage limitation on charitable donations. There is already authority in *Olympia Floor* for deducting, as a business expense, contributions to charities where the taxpayer was able to document a subsequent increase in sales.[102] Conceptually, if the charitable donation is reduced by an amount representing the benefit of goodwill then, in most instances, an offsetting business expense must be allowed.

Second, if the benefit is something less than goodwill, then the connection between the contribution and any specific benefit may be too weak. Although the community respect gained when an individual or corporation acts philanthropically may in fact cause people to deal with them in a business context, this type of benefit is too remote to be considered under the benefit test.

The last example in this catch-all category raises a nexus problem similar to the ones we have already looked at. In *Blake* v. *Commissioner of Internal Revenue*,[103] a taxpayer, about to donate an old-fashioned sailing vessel to a merchant marine academy, received some better tax advice. In the eleventh hour, he arranged to donate corporate stock worth approximately $700,000 instead of the vessel. The taxpayer expected the charity to sell the stock and use the proceeds to purchase the vessel for $675,000. The

---

charitable purposes, it would merely take the proceeds and donate them itself, thus obtaining a charitable tax deduction. However, because the State of Western Australia pays no taxes, and it does not, therefore, need a charitable tax deduction, it can sweeten the deal by shifting the deduction to a taxpaying entity. This is not an appropriate use of tax exempt status, by either a governmental unit or an ordinary charity. However, from the perspective of an economic benefit test, the transaction may be sound. It would, however, fail under the compulsory payment test to be discussed later.

[101]See, generally, *Minister of National Revenue* v. *Kellogg Co. of Canada* (1943), [1943] S.C.R. 58, [1943] C.T.C. 1, 2 D.T.C. 601; *Canada Starch Co.* v. *Minister of National Revenue* (1968), [1969] 1 Ex. C.R. 96, [1968] C.T.C. 466, 68 D.T.C. 5320; *Minister of National Revenue* v. *Algoma Central Railway* (1968), [1968] S.C.R. 447, [1968] C.T.C. 161, 68 D.T.C. 5096.

[102]*Supra*, note 40.

[103]697 F.2d 473 (2d Cir. 1982) [hereinafter *Blake*].

transaction proceeded as planned. In a subsequent transaction the charity sold the vessel for $250,000. In essence, the taxpayer funded the purchase of his vessel at a highly advantageous price. There is an economic benefit in the purchase of the vessel, but the contribution funding the purchase is a technically unrelated event. The nexus may nevertheless be found by using a "but for" test: but for the donation of the stock, the charity would not have proceeded with the purchase of the vessel.

C. Test Three: Compulsory Payments

With subjective intent relegated to a low threshold test, most gifts made with mixed motives will easily qualify for the charitable deduction. The primary test for distinguishing charitable gifts from personal and business transactions thus becomes the economic benefit test. An examination of the cases and the Internal Revenue Service's Revenue Rulings reveal a narrow category of business transactions which are not dealt with by the combined effect of the first two proposed tests.

The Australian *McPhail* rule suggests a third test which can be effectively applied. It requires that a charitable gift be property "transferred voluntarily and not as the result of a contract obligation."[104] There are, however, several problems with the test as formulated in *McPhail*. It is unclear whether the requirement of voluntariness is a separate requirement or merely synonymous with the contract element. Also, as pointed out by Bowen C.J. in *Leary*, not all payments pursuant to contractual obligations should be excluded from the ambit of charitable gift.[105]

For these reasons, the proposed third test incorporates a broad definition of voluntary transfer and narrows the contract requirement to commercial contracts. Under this test, a charitable gift is not deductible if the transfer was compelled by statute, regulation, court order, commercial contract or to fulfill a pre-condition. The following examples will illustrate when this test may be important.

In Revenue Ruling 79-148,[106] the taxpayer, a manufacturer, was convicted of selling certain products to country X in violation of United States

---

[104]*McPhail, supra*, note 19 at 116. An interesting aspect of the *McPhail* contract test is the different approaches of the various common law jurisdictions as to whether a contract exists. The Australian cases — *McPhail*; *Case E44, supra*, note 78; and *Case F40* (1974), 74 A.T.C. 223 (Tax'n Bd of Rev.) — found the existence of a contract without much discussion. In *McBurney* (T.D.), *supra*, note 4, the Canadian Federal Court took a narrower view of contract formation. The most radical approach was in *Blake, ibid.*, where the United States Court of Appeals used equitable estoppel to construe a contract. It is unlikely that Canadian courts would follow this route.

[105]*Supra*, note 81 at 230.

[106]Rev. Rul. 79-148, 1979-1 C.B. 93.

federal law. The taxpayer offered to contribute to a charity an amount equal to the maximum fine imposed by statute for this crime. The taxpayer was sentenced to two years' imprisonment, but the sentence was suspended. The payment to charity was incorporated by the judge as a condition of probation.

Although the taxpayer's offer to make a contribution to charity clearly influenced the court's sentencing it would be difficult to pinpoint an economic benefit, and thus the second test would not disqualify the deduction. Presumably, the taxpayer could demonstrate a charitable motive for the gift, such as a sincere desire to repent or reform through good works, and would thus pass the low threshold of the subjective intent test. Only the third test would provide a clear basis for denying the charitable deduction.[107]

Allen, one of the land dedication cases, is an example of a clearly business-motivated transaction which might, under some circumstances, pass tests one and two. In order to get a zoning variance for half-acre lots in an area zoned for one-acre lots, the taxpayer donated 9.2 acres of redwood trees to the city for green space. The court accepted the taxpayer's testimony that his primary motive for donating the land was to preserve the redwoods, which the court interpreted as a charitable act. Applying the subjective intent test, a charitable contribution was upheld.[108]

An economic benefit test would have focused on the increase in value of the adjoining property following the dedication of the open space and the zoning variance. As the dissenting opinion points out, the new development would be more attractive to prospective purchasers because of its proximity to the open space. However, arguably in the *Allen* case there was no net increase in value. The majority opinion emphasized the taxpayer's evidence that it was more costly to develop the property under the new plan than it would have been if he had built within the existing one-acre lot requirement. From a net profit perspective these factors might have offset each other. However, the business motive may have been to increase the ease of sale, rather than to increase the total profit. Consequently, the economic benefit is hard to pinpoint. Under the proposed third test, the contribution of the property would be viewed as a pre-condition to a zoning change and the charitable deduction denied. Similarly, in other land dedication cases, where the taxpayer is complying with regulations or statutes, the issue would be dealt with summarily under the third test.

---

[107]There is, of course, another tax policy basis for disallowing the deduction. Arguably, the payment is a type of penalty which should not be deductible as a business expense under *ITA* para. 18(1)(a) and, therefore, should not be allowable under *ITA* s. 110 either. See, generally, *Day & Ross Ltd* v. *R.* (1976), [1977] 1 F.C. 780, [1976] C.T.C. 707, 76 D.T.C. 6433 (T.D.).

[108]*Allen*, *supra*, note 54.

The final example comes from Bowen C.J.'s implicit criticism in *Leary* of the *Cyprus Mines* reasoning.[109] In *Cyprus Mines* the taxpayer elected to make a donation to the charity rather than pay the royalty to the State of Western Australia. Arguably there was no real economic benefit since the dollar amount paid out was the same. The economic benefit test is thus insufficient to isolate the commercial element. However, payments made pursuant to a commercial contract would be caught by the proposed third test.

Conclusion

Deane J. in *Leary* commented on the word gift:

> It is a monosyllabic old English noun of Norse derivation which designates a descriptive category of transfer of property. Once it is accepted that it is to be given the meaning which it bears as a matter of ordinary language, it is not to be assumed that its ambit can properly be defined, with a lawyer's or a logician's precision, by reference to a number of unqualified propositions or tests or by identification with different polysyllabic words whose etymological origins provide greater scope for reasoning as to precise meaning.[110]

It may be that this lengthy justification for the proposed three-tiered test is such a fruitless logician's pursuit. However, the lack of a consistent approach evidenced by the *Burns*, *Aspinall* and *McBurney* cases, and the challenge to Revenue Canada's apportionment approach by the Federal Court Trial Division in *McBurney*, certainly demand attention. The American cases show the weakness of using one test alone. The two test approach of the Australian *McPhail* rule has recently been criticized in *Leary*[111] which, surprisingly, introduced the subjective intent test articulated by the United States Court of Appeals, Ninth Circuit, in *DeJong* without exploring its criticisms.

Whatever the approach, there has been too little attention paid to the tension between the tax policy of encouraging charitable contributions and both the general prohibition against deducting personal expenses and the tax equity considerations of treating charitable and business suppliers of goods and services the same. In the proposed approach, tests one and three eliminate transactions motivated almost exclusively by commercial and non-charitable considerations. They form a wide mesh screen through which most transactions will easily pass, and hence do not inhibit charitable giving.

---

[109]*Leary*, *supra*, note 81 at 230ff., criticizing *Cyprus Mines*, *supra*, note 80.
[110]*Supra*, note 81 at 241.
[111]*Ibid.* at 242-43.

Test two is based on the premise that charitable gifts are motivated by a complex mix of objectives. Thus it only seeks to reduce the quantum of the gift by the actual economic benefit received. This, it is hoped, will preserve the element of charity in the charitable deduction provisions.