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BANYAN TREE CLASS ACTION RECEIVES CERTIFICATION

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A. INTRODUCTION

On January 19, 2010, Justice Lax of the Ontario Superior Court of Justice certified a class proceeding brought on behalf of 2,825 individuals who participated in the Banyan Tree Foundation Gift Program (the "Gift Program") against the promoters of the program and a law firm that provided legal opinions in support of the program.[1] This decision is significant because it is the first certification of a class action relating to leveraged donation gifting arrangements in Canada.

B. BACKGROUND

The Gift Program was operated from 2003 to 2007 and had a structure typical of many leveraged donation gifting arrangements. Generally, a taxpayer receives a pre-arranged loan and makes a donation of the loan proceeds plus additional cash to a registered charity in return for a charitable donation receipt. The taxpayer is not at risk for the loan and the charity must use the proceeds in a predetermined manner.

Each participant in the Gift Program pledged a donation of a specific amount to the Banyan Tree. The participant contributed 15% of the pledged amount from their own resources and 85% was financed by a non-recourse loan evidenced by a promissory note. The participant paid a security deposit to the lender, which was to be invested and used to pay the interest, taxes and principal amount of the loan. The participant

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[1] *Robinson* v. *Rochester et al.*, 2010 ONSC 463 (CanLII). The full text of the decision is available at: http://www.canlii.org/en/on/onsc/doc/2010/2010onsc463/2010onsc463.html.

received a charitable donation receipt for the full amount pledged. It appears from the Court's decision that the Canada Revenue Agency ("CRA") has determined that the Gift Program was a sham and that it has or will have reassessed all of the participants to deny their claims for a charitable donation tax credit related to their participation in the Gift Program.

Leveraged cash donations are one form of tax shelter gifting arrangement that has been flagged by CRA for increased audit activity. It has issued several Taxpayer Alerts warning taxpayers that it intends to audit tax shelter gifting arrangements, including leveraged cash donations. Every such audit completed to date has resulted in a reassessment of taxes, plus interest and in some cases the CRA has denied the gift completely.[2]

It is important to note that the charitable status of the Banyan Tree Foundation was revoked by CRA in September 2008 largely because of its involvement with the Gift Program – CRA was of the view that the Foundation was operated for the non-charitable purpose of promoting a tax shelter arrangement and for the private benefit of its directors. The notice published in the *Canada Gazette* on September 20, 2008, revoking the charitable status, indicates that the revocation is pursuant to paragraph 168(1)(b) of the *Income Tax Act* for failing to comply with the requirements for registered charities in the *Income Tax Act* and paragraph 169(1)(d) of the *Income Tax Act* for issuing donation tax receipts that do not comply with the *Income Tax Act* or contains false information. A *Globe and Mail* article on September 20, 2008 indicates that CRA alleged that the loans were never funded, and the Banyan Tree used the cash portion of the donations primarily to pay for fees to promote and administer the gifting program.[3]

C. THE CLAIMS

In their claim against the promoters, the plaintiffs pled breach of contract and negligence and sought a declaration that the promissory notes issued by the participants as part of the Gift Program are void and unenforceable. The plaintiffs allege that it was an express or implied term of the contracts between the participants and the Gift Program promoters that the participants would receive a charitable donation tax receipt that would be recognized by CRA and that they would not be at risk to repay the loans. With respect to the law firm, the plaintiff's allege that the legal opinions were a necessary prerequisite for the promotion

[2] Canada Revenue Agency, Taxpayer Alert: "Warning: Participating in tax shelter gifting arrangements is likely to result in a tax bill!" August 13, 2007.
[3] For further information please see *Charity Law Update* September 2008 available at http://www.carters.ca/pub/update/charity/08/sep08.pdf and CRA's News Release dated October 20, 2008 available at http://www.cra-arc.gc.ca/nwsrm/rlss/2008/m10/nr081020-eng.html.

and sale of the Gift Program, without which the gift program could not have been launched. The plaintiff's pled that the law firm intended the participants to rely on the existence of the opinions in deciding whether to participate in the Gift Program and that the firm was negligent in the preparation of the opinions.

D. THE DECISION

The judge applied the test for certification set out in Section 5(1) of the *Class Proceeding Act*. An action must be certified as a class proceeding where the following five requirements are met: (a) the pleadings or the notice of application discloses a cause of action; (b) there is an identifiable class of two or more persons that would be represented by the representative plaintiff; (c) the claims of the class members raise common issues; (d) a class proceeding would be the preferable procedure for the resolution of the common issues; and (e) there is a representative plaintiff who, would fairly and adequately represent the interests of the class, has produced an adequate litigation plan and does not have an interest in conflict with the interests of other class members on the common issues for the class. The judge was satisfied that the plaintiffs had met each requirement for certification and the claim against the Gift Program promoters and the law firm will now proceed as a class action.

One of the key issues in the decision concerned whether there was a sufficient cause of action against the law firm that prepared the opinion letters in support of the Gift Program. The plaintiffs argued that the law firm provided the letters (1) with the intention that they be used by the Gift Program promoters to market the program as one in which participants would receive a charitable tax receipt recognized by CRA; and (2) with the intention and knowledge that the existence of a tax opinion would inform the decision of participants about whether or not to participate in the gift program. The Court found that if these allegations are made out at trial, it is not plain and obvious that they could not support a duty to take care that the opinions expressed in the letters were accurate and reliable and that a failure to take such care or a failure to warn was the proximate cause of the losses the plaintiffs allege they suffered notwithstanding the express limitations in the opinions regarding who could rely on the opinions. The Court recognized that there is precedent for advancing a class action claim in negligence against a law firm even though generally, a lawyer owes a duty of care only to the lawyer's client. The Court then found that

> it is certainly arguable that FMC ought reasonably to have foreseen that its tax opinion would be used to market the gift program and that the participants would be "disappointed" and suffer damages if FMC was negligent in giving that opinion. In my view, FMC placed itself in a relationship of sufficient proximity to

> owe a prima facie duty of care to the plaintiffs and proposed class members and I would leave to trial the question of whether policy considerations ought to negative that duty.[4]

E. LEGISLATIVE AMENDMENTS

While substance of the class action will not directly involve the *bona fides* of the Gift Program structure, proposed changes to the *Income Tax Act* related to split-receipts and donation tax shelters will significantly impact how these transactions were treated on an assessment and provide important context for any assessment of the law firm's opinions. New subsections 248(30) to (41) are proposed to be inserted in the Act to allow a donor to receive a donation tax receipt even in situations where the donor or someone else received a limited advantage as a result of the gift.[5] Under the proposed amendments donors are permitted to receive something in return for a donation provided the amount of the donation is reduced by the amount of any advantage received by the donor and a receipt is only issued for the eligible amount of the gift. Subsection 248(31) provides that the "eligible amount" of a gift is the amount by which the fair market value of the property transferred exceeds the amount of the advantage in respect of the gift. A broad definition of "advantage" is set out in subsection 248(32) of the Act.

Several proposed amendments introduced in December 2003 were designed to reduce the tax benefits available from charitable donations made under tax shelter gifting arrangements such as the leveraged donation structure used in this case. With the addition of paragraph 248(32)(b), the proposed definition of advantage includes the amount of limited-recourse debt incurred in respect of a gift at the time when the gift is made, as determined pursuant to the newly introduced definition of limited recourse debt in proposed subsection 143.2(6.1). The purpose of these proposed amendments was to curtail abusive tax shelter schemes involving leveraged donations.[6] The amendments apply to gifts made on or after February 19, 2003. The cumulative effect of paragraph 248(32)(b) and subsection 143.2(6.1) is to reduce the amount of the gift made by the donor by the amount of the loan borrowed if the indebtedness is of limited recourse to the lender or if there is a "guarantee, security or similar indemnity or covenant" in respect to that debt or any other debts.

[4] Paragraph 31 of the decision.
[5] These amendments were first introduced as part of Draft Technical Amendments to the ITA released on December 20, 2002. After a series of changes and revisions, the proposed amendments were reintroduced in Bill C-10 which was under review until it died on the Order Paper on September 7, 2008, as a result of the dissolution of the Parliament. These amendments have not been re-introduced in Parliament for enactment although the Department of Finance has indicated that this may occur as part of the 2010 budget. CRA has indicated that they are applying these provisions as if enacted and they likely form the basis of the assessments and reassessments at issue herein.
[6] Department of Finance News Release 2003-061 (December 5, 2003).

The Department of Finance noted that debt incurred as part of a leveraged cash donation will be considered to be limited-recourse debt if it is to be repaid under an arrangement such as a guarantee, security, or similar indemnity or covenant in respect of the debt structured as part of the donation arrangement, structures seemingly very similar to those in the Gift Program, although we have not reviewed the actual documents.

Proposed subsection 248(34) deals with the repayment of limited recourse debt. This subsection generally provides that a repayment of the principal amount of a limited-recourse debt in respect of a gift is deemed to be a gift in the year it is paid. However, in some situations, the total amount of limited-recourse debt and other advantages to the donor may exceed the fair market value of the property transferred to the charity, thereby resulting in no eligible amount being available to the donor. In such cases, the donor would need to pay off the excess amount before any amount will be allowed as a gift. The Technical Notes to this provision explains that "a payment financed by other limited-recourse debt or made by way of assignment or transfer of a guarantee, security or similar indemnity or covenant is not recognized for these purposes." Examples in this regard include "the assumption of a taxpayer's limited-recourse debt by another person, in exchange for an insurance policy in favour of the taxpayer that guarantees a particular rate of return on an investment held by any person, would not qualify as a deemed gift under subsection 248(34)."[7]

Notwithstanding the fact that these amendments have fallen off the legislative agenda and have not yet been enacted, CRA already requires charities to comply with the proposed split-receipting rules and is applying these rules in its assessments and reassessments. Therefore, any leveraged donations made on or after February 19, 2003, including those that are part of the Gift Program, will likely be dealt with on the basis of the proposed amendments.[8]

[7] Department of Finance, Technical Notes released February 18, 2008.

[8] Although these proposed changes have not been enacted, Canada Revenue Agency ("CRA") released Technical News No. 26 on December 24, 2002, concerning proposed new rules for split-receipting which is premised on these proposed changes. Furthermore, the British Columbia Supreme Court in *Richert* v. *Stewards' Charitable Foundation* [2005] B.C.C.J. No. 279 up-held compliance with Technical News No. 26, as required by CRA. In this regard, CRA's Registered Charities Newsletter No. 17 specifically indicates that the proposed guideline in Technical News No. 26 "can be relied on now, despite the fact that the proposed legislation is not yet law." For details, please refer to the following Charity Law Bulletins available on our website at www.charitylaw.ca:
Charity Law Bulletin No. 23, "New CCRA Guidelines on Split-Receipting," dated July 22, 2003; and
Charity Law Bulletin No. 68, "B.C. Court Upholds CRA Guidelines on Split-Receipting," dated April 7, 2005.

F. CONCLUSION

It is noteworthy that this class action has not been brought against the Banyan Tree Foundation or its directors, possibly because there are insufficient assets to warrant a claim. However, registered charities and their directors should be aware that such a possibility exists and should therefore avoid any participation in tax shelters for this reason, even if they choose to ignore the many warnings issued by CRA.

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