

The Tax Credit System: Blessing or Burden?

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When in 1930 William Euler, the Minister of National Revenue, acceded to the demands of the Leader of the Opposition, R.B. Bennett, to extend income tax exemptions in the *Income War Tax Act* to include gifts to charitable organizations, he could scarcely have imagined the enduring significance of his acquiescence. The amendment proposed by Bennett sought to remove the discrimination against “deserving institutions” which was implicit in restricting tax exemptions to donations to schools, hospitals, universities, and churches, by broadening that section of the act to include such federated charities as the Red Cross and local community chests. Members of all parties agreed to the amendment, and in recognition of Mosaic law that one-tenth of an individual’s income should be given to the church (tithing), a provision was included in the act allowing for a maximum of 10 per cent of any taxpayer’s income to be exempt from taxation through such donations. On 28 May 1930, Bill 310, an *Act to Amend the Income War Tax Act*, received third reading in the House of Commons, and with the passage of the act the first provisions for tax credits became law.¹

From 1930 to 1935 during R.B. Bennett’s own tenure as Prime Minister, additional amendments were made to the *Income War Tax Act*, so that by 1935 it included provisions allowing for tax exemptions for gifts or donations to charitable organizations, educational institutions, and the “Dominion of Canada or any province or political subdivision thereof.”² The confidential nature of individual tax returns makes it impossible to determine how extensively these provisions were used, although there can be little doubt that for some people at least they provided tax relief for cash gifts to registered charities. It is known, however, that some thirty years after the inclusion of these exemptions in the *Income Tax Act* the Department of National Revenue (now Revenue Canada Taxation) still discouraged:

... extending the donation allowance to gifts of property, which are generally referred to as “gifts in kind.” It has been felt that there would be many claims made by persons who would choose to get rid of

* The opinions expressed here are those of the author and are not necessarily indicative of the policy of the Public Archives of Canada or the National Archival Appraisal Board.

1 *Hansard*, 1930, pp. 2645-50; 2714-15. See also *Statutes of Canada, 1930* (Ottawa, 1930), p. 232.

2 *Statutes of Canada, 1935* (Ottawa, 1935), p. 223. For the complete text of the *Income War Tax Act* and notations concerning amendments, see *Income War Tax Act and Excess Profits Tax Act 1940* (Toronto, 1948), especially pp. 301-3.

accumulated junk around their homes and give articles of doubtful value to church and other charitable agencies which might have rummage sales or similar activities.³

The Department of National Revenue did recognize that gifts of books or works of art to institutions such as universities did have a value, and where such gifts were received the possibility of a tax exemption would be considered. A problem arose, however, in determining the value of the donation, and National Revenue officials cautioned that a reasonable value was "not always that determined by the recipient organization itself." Instead, they advised that it was preferable to have independent, expert appraisers evaluate the gift, but always on the understanding that officials of their Department could and would challenge any assessment that they considered too high.⁴

The growing use of tax credits in the United States in the late 1960s focused increasing attention on tax exemptions for gifts in kind, and with it developed the notion that archives could use tax benefits as an incentive to donors. Still, officials at the Department of National Revenue remained skeptical about the whole process and continued to express concern about the availability of evaluators with the competence to appraise such specialized material. At the suggestion of Dr. W.I. Smith, then Acting Dominion Archivist, National Revenue agreed to accept appraisals of archival material done by reputable book dealers, but indicated that they would prefer that such appraisals be done by a team of historians or archivists constituted as a committee of the Canadian Historical Association (CHA).⁵

With this concession from National Revenue, the CHA Archives Section was approached and asked to form an appraisal committee consisting of "archivists, historians and representatives of other cognate professions."⁶ The CHA agreed, and at their annual meeting held in Winnipeg in 1970 a Document Appraisal Committee was formed to "assess for income tax purposes the market value of documents presented to Canadian archives and institutions."⁷ After four years and forty-two appraisals, it was decided that the Document Appraisal Committee of the CHA should be reconstituted into a National Archival Appraisal Board (NAAB), although it was to remain a committee of the CHA. Established in 1974, NAAB offers

... appraisal services for historical materials donated to archival repositories in Canada. The appraisals shall be conducted on all forms of historical material which shall have been donated by the donatory, or

3 J. Delavignette, Assessments Branch, Department of National Revenue, to L.G. Macpherson, Vice-Principal (Finance), Queen's University, 13 October 1966. This same paragraph was included in a letter from another revenue official to Dr. W.I. Smith, Dominion Archivist, 19 May 1970. All correspondence cited here and below refer to copies in the possession of R.S. Gordon, Director, Manuscript Division, PAC.

4 Delavignette to Macpherson, 13 October 1966.

5 K.D. Lunam, Department of National Revenue, to W.I. Smith, 19 May 1970. See also R.S. Gordon, "Appraisals for Tax Credit by the National Archival Appraisal Board," *Archivaria* 1 (Winter, 1975-76), pp. 74-75.

6 *Ibid.*, p. 75.

7 "Document Appraisal Committee," *The Canadian Archivist* 2, no. 3 (1972), p. 62.

shall have been placed in the custody of a repository with the *bona fide* intention of donating the materials to the repository regardless of the outcome of the appraisal.⁸

NAAB continued to function under the auspices of the CHA until 1983 when, as a result of the growing demand for appraisal services and the increasing requirement for expertise when appraising archival material, it was incorporated as a separate entity.

In 1974 Revenue officials also agreed to allow qualified archivists within an institution to appraise collections donated to their repository, as long as the material was of modest value. At the time the monetary value of an “in-house” *versus* “arm’s-length” appraisal was not specified, although over time the dividing line came to be established at one thousand dollars. Yet despite their impetus to the creation of NAAB and their approval of the use of indigenous experts for “in-house” appraisals, Revenue Canada continued to advise against giving any publicity to tax credits. It was even suggested that archives should refrain from providing donors with any information about the availability of tax credits,⁹ perhaps because Revenue Canada still feared an influx of “accumulated junk” and the subsequent demand for tax exemptions.

With the passage of the *Canadian Cultural Property Import and Export Act* in 1977, the practice of issuing tax credits for donations to archives, museums, and art galleries became firmly established. While the *Cultural Property Tax Act* did not alter or amend the *Income Tax Act* in this regard, it did add further, and substantial, monetary incentives to donors. The “carrot” that the *Cultural Property Act* extended to donors was a 100 per cent exemption from capital gains tax for the appraised value of certified cultural property donated to a designated Canadian institution. Two additional steps were thus added to the appraisal process — designation of the recipient institution and certification of the cultural property — and the responsibility for both devolved onto the institution receiving the gift.¹⁰

In response to the growing number of receipts being issued for tax purposes by Canadian repositories — the number of collections appraised by NAAB, for example, rose from 43 in 1977 to 118 in 1982 — Revenue Canada issued *Gifts and Taxation: Donations in Kind* in 1982 as one of its tax information pamphlets.¹¹ The issuance of this pamphlet was significant, for it indicated that officials at Revenue Canada were both prepared to publicize the availability of tax credits and to elucidate for the public and curators of cultural institutions their reciprocal rights

8 Constitution of the National Archival Appraisal Board, 1974, p. 1.

9 R.S. Gordon, Public Archives of Canada, to G.J. O'Reilly, Revenue Canada, 6 May 1974, p. 4, confirming the details of an earlier discussion with Revenue officials.

10 See Duncan Cameron, *An Introduction to the Cultural Property Export and Import Act* (Ottawa, 1980), p. 19. Designation involves a single application, and can be one of two types: Category “A” for institutions which are designated indefinitely “for general purposes relative to their mandate to collect and preserve ... movable cultural property”; and Category “B”, for those institutions designated indefinitely “with regard to a specific cultural property qualifying for certification.” Application for certification must be made for each specific collection, document, artifact, or work of art acquired, and the application is then reviewed by the Cultural Property Review Board to determine if the material meets the dual requirements of “outstanding significance and national importance.” Such application can only be made after the material has been irrevocably donated to the repository, and only designated institutions may submit applications.

11 *Gifts and Taxation: Donations in Kind* (Ottawa, 1982).

and responsibilities when making and accepting donations. The pamphlet was sufficiently popular that a revised edition entitled simply *Gifts in Kind* was published in 1983 to incorporate the proposed amendments to the *Income Tax Act* contained in Bill C-139 which had been introduced in the House of Commons on 7 December 1982. The principal change proposed in Bill C-139, and subsequently passed into law, allowed a donor to carry forward for up to an additional five taxation years any portion of the value of a gift that could not be used against his taxable income for the year in which the donation was made. Prior to this amendment, any residual amount of the appraised value of a gift could only be carried forward for one additional year. This extension was included in the amendments in recognition of the increasing value of the cultural property being donated to institutions, and the inability of many donors to deduct the full amount of the appraised value of their gift in two taxation years.

It is only on rare occasions that Revenue Canada acts to provide taxpayers with the means to reduce their taxable incomes, yet despite their initial ambivalence toward tax credits for gifts in kind they have moved in the last decade to do precisely this. And whether because of, or in spite of, their activity, tax credits for donations of archival material have become increasingly popular. The growth in the number of appraisals conducted at the Public Archives of Canada in the past three fiscal years, for example, provides one indication of this: 1980-81: 110; 1981-82: 119; 1982-83: 161.¹² Yet while tax credits are being enjoyed by more donors each year, they have begun to pose serious problems for archivists faced with the annual onslaught of acquisitions for which tax credits are requested.

One such problem with these collections is their unpredictability: it is impossible to know just how many collections will have to be appraised for any given taxation year until the archives closes its doors on the last working day of December of that year. Revenue Canada regulations require that a collection be evaluated and the receipt issued for the taxation year in which the donation is made, and it has become increasingly common for donors to contact an archives late in the year, apparently after having done some preliminary calculation of the tax they are faced with paying if additional deductions are not found, and insist that the archives accept their collection. In this sense the system is working well as the incentive to donate material in return for a tax credit is attracting donors to archives. Yet unexpected donations late in the year can, and often do, create havoc with existing work schedules as donors are anxious to have their receipts by February or March of the following year so that they may prepare their income tax returns. And while archives are under no compulsion to accept gifts under such conditions, if they wish to acquire the collection, maintain good donor relations, and serve their research clientele, there is really very little choice. Some archives have been able to defer acceptance of gifts until the following year, thereby easing the burden of complying with late requests, but it is not always possible to do so.

Acceptance of a collection on the understanding that an evaluation will follow necessitates not only a shift in work priorities in the coming months, but if several collections are to be appraised can also lead to a situation where nothing but

12 Figures quoted are for all appraisals, both those by staff and outside appraisers, done each year. See Public Archives of Canada, *Annual Report* (Ottawa, 1981), p. 53; (1982), p. 59; and (1983), p. 45.

appraisal-related work is being performed. "In-house" appraisals seemingly require less work than do "arm's-length" appraisals, but it is more often a matter of scale as the amount of time required — to verify items, consult auction catalogues for prices being asked and prices realized for similar material, search the holdings of one's own and other archives for related records, determine the "fair market value" and substantiate that decision — is proportionately similar for both large and small collections. This process also requires considerably more work than it would have taken to routinely accession the collection if no appraisal had been requested.

Arm's-length appraisals, or those performed by third parties, create all the work of in-house appraisals, as well as necessitating the preparation of extensive reports and listings of the contents of the collection. While some private appraisers will examine and evaluate a collection in an unprocessed state, NAAB requires that the collection be organized and described before their members will undertake an evaluation. This requirement creates more immediate work for the archivist, but it is argued that processed collections can be appraised more quickly and accurately, thus ensuring greater efficiency and reduced costs for institutions using their services. There is merit in this argument, but what is often overlooked is the additional time and attention required to prepare such descriptions — time and attention that archivists would perhaps like to devote to all of their collections — and that the extra time spent on such collections means that others will be relegated to the backlog for longer periods of time.

Most archivists have been forced to accept — albeit reluctantly — that a portion of their holdings will always be unprocessed as the volume of acquisitions outstrips their resources to process material. What has happened with the demystification of the tax credit system, however, is that after donating a significant collection of papers to an archives and receiving a handsome tax rebate, some donors appear to be virtually creating documents on an annual basis with the specific intention of donating them to an archives for further tax relief. Fortunately, there are still only a few entrepreneurs participating in this new "cottage industry," but the number could easily grow as more people become aware of this method of "beating the taxman."

Acceptance of the gift by an archives also incurs a series of statutory obligations both to the donor and to Revenue Canada. The obligations to the donor are relatively straightforward, in that the archivist agrees to have the collection appraised and a receipt issued for the taxation year in which the gift is made. Revenue Canada's requirements are somewhat more demanding, however, for they place the responsibility on the institution issuing the receipt for ensuring that the appraised value is reasonable and that it represents the "true value of the donation at the time it was donated."¹³ Thus, while the appraisal may be done by an independent third party, the recipient institution is also accountable to Revenue Canada should the appraisal be challenged. Receipts must be issued as soon as possible after the end of December, and must contain specific information if they are to be acceptable to Revenue Canada and to have the requisite force in law.¹⁴

13 *Gifts in Kind* (Ottawa, 1983), p. 5.

14 *Ibid.*, pp. 9-10.

The strict format required for receipts has meant further expense for archives and the imposition of additional administrative responsibilities which, particularly in small institutions, are sometimes difficult to meet. It has also meant that more staff time is consumed performing non-archival work, time that is sorely needed for archival functions. Additional expense also results from the actual appraisal of the collection for most archives willingly agree to assume this cost. Appraisal costs can be extremely high if private appraisers are engaged, as they usually charge a substantial daily fee plus expenses. Others base their fee on a percentage of the appraised value of the collection, and such percentages can vary anywhere from 2 to 15 per cent. Even if NAAB's services are used, the *per diem* fee is seldom less than five hundred dollars, and if several days' appraisals are needed during the year a considerable expense can result. More time spent on administration or a few hundred dollars additional cost for appraisals may seem like a small price to pay if it means acquiring a significant collection — and indeed it is if the value of the collection is correspondingly high — but in cases where the collection is of questionable value it involves an archives in unwarranted expenditures of both time and money.

Archives do not, of course, have to accept every collection which is offered to them, but I suspect few collections are refused. It is the archivists' vocation to preserve the past, and few will not be able to find at least one redeeming feature in every collection. The papers of a donor who "manufactures" documents for a tax credit each year, for example, are accepted as failure to do so will lead to fragmentation and an incomplete collection. Additional accessions will also be accepted from a donor who consciously presents only a portion of his collection each year so that he will receive a manageable tax credit, although acceptance necessitates an appraisal and the resultant administrative work each year as well. And archivists will also accept donations which they know have little or no monetary value to avoid a confrontation with a donor and the possibility of bad publicity which might result from their refusal. In such cases the fault rests with the archives for continuing to accept the material, although the problem is aggravated by the existence of the tax credit system.

There can be no doubt that the availability of tax credits has encouraged many donors to present material to archives with which they might otherwise have been reluctant to part. The corollary of this, unfortunately, has been that few donors when apprised of the availability of a tax credit do not request one — even if they had previously intended to donate their papers without monetary reward. This perhaps is the basic problem with the system, for tax credits have not only succeeded in luring collections away from reluctant donors and into archives, but they have also endangered philanthropy as most donors are now exercising their legal right and requesting an appraisal. The result is an increase in the quantity of acquisitions each year, but the beneficial aspects of the system are being jeopardized by the burden imposed by collections of dubious value.

If archivists accept the benefits of the system, they must also accept this burden, but acceptance need not entail acquiescence. Selection criteria must be developed and applied for *all* acquisitions, and archivists must decide if they really want the collection being offered; if by accepting it for appraisal it will mean that other, more important papers will remain unprocessed; if the acceptance of the collection could be deferred until the next taxation year (or if this will result in the collection being

lost); and if the collection is of sufficient archival and historical value to warrant the extra work required to have it appraised. If the answer to any of these questions is in doubt, then further reflection is necessary before the collection is accepted and a tax credit issued.

Similarly, archives should contemplate whether or not they wish to continue to assume the cost of having collections appraised. There is no legal requirement for the recipient institution to absorb this cost, and if securing an appraisal and paying its cost were left to the donor it could well result in fewer collections of marginal value being presented to archives. Under the present system — and so long as archives continue to underwrite the costs — the donor takes no risks, receives a free appraisal, and obtains an income tax rebate merely for donating the papers to the archives.

In summary, the tax credit system is working well in providing an incentive to donors to present material to archives, and perhaps many of the problems now being encountered result from the system working *too* well. If archivists imprudently continue to accept everything offered, they will indeed be guilty of appraising people's "accumulated junk," and with this will come retaliation from Revenue Canada in the form of more rigid controls or even revocation of the tax exemption provisions for gifts in kind. It is incumbent upon archivists, therefore, to ensure that the system is not abused so that it may continue to benefit archival institutions by attracting significant collections. The burden of the tax credit system will be endurable only as long as the blessings follow. Without them, the burden could well become so oppressive that it will crush the entire system.