ABSTRACT  This article addresses the thematic parameters of Canadian charitable tax policy and opportunities for new charitable giving incentives. The author outlines the shift in tax policy since 1996 to encourage donations of assets (typically capital property) rather than income, which has made the Canadian incentive system the most generous in the world. Recent tax policy changes have increased giving but have (perhaps) done so at the expense of small charities and “ordinary” donors. Some recently proposed measures to boost giving are outlined, with particular emphasis on increased tax credits and the elimination of capital gain on real estate and private company shares. The balance between philanthropy and tax support may be close to being reached in the Canadian system.

KEYWORDS  Charitable tax policy, Charitable giving
ONE OF THE FEW POSITIVE ASPECTS OF THE GLOBAL ECONOMIC CRISIS THAT started with a bang in the autumn of 2008 is that it provides an opportunity for innovation. What has worked in the extended boom of the last 15 years is suddenly in question. What’s up is now down—both literally and metaphorically. There is debate in all parts of society to find solutions to economic troubles. Nobody wants to waste a good crisis.

In the charitable sector, the budding recession and the federal “fiscal stimulus” budget of January 27, 2009, re-ignited the debate over the role of tax incentives for giving. A number of groups came forward with proposals to support the sector and increase giving. Ultimately, the government adopted none of the proposals. The budget instead focused more on direct expenditures on programs in areas such infrastructure projects, social housing, the arts, sport and recreation. Other pressing opportunities, such as social enterprise and social finance, were also ignored by the budget.

The lack of new charitable incentives in the January 2009 budget was only a surprise because the charitable sector has become used to being included. Charities have been the beneficiary of a series of tax incentives in recent history. Since 1996 Canada has overhauled the Income Tax Act to encourage and regulate charitable giving. Depending on how you count them, there have been at least 20 new tax incentives to foster greater charitable giving. When compared to other industrialized nations, Canada now has, arguably, the most generous tax regime to provide direct support to taxpayers for charitable donations. So have we hit a policy plateau? What can be improved? What is the right balance between government subsidy of donations and personal cost?

What struck me about the sector consultations in advance of the January Budget was their improvised nature. To be fair, the timetable of the consultations was to blame, not the sector’s response. The global economic situation and political urgency drove the schedule, and there was not so much a lack of thoughtfulness as a lack of time. It is probably positive that nothing was introduced in haste that the sector would have time to regret at leisure. We now have an opportunity to take stock of the charitable incentive regime in the Income Tax Act (Canada) and review what we have, why we have it, and what policies are most successful, with the goal of creating a regime that encourages a balance of public benefit, donor incentives, trust, and the appropriate level of government involvement.

To frame the discussion about tax incentives, I will first outline the parameters of Canadian charitable tax policy to clarify the system as it currently exists, focusing on policy themes rather than detailing specific measures. By understanding our current system better, we can identify the areas where tax policy can provide the greatest benefit to society through charitable giving. I will then examine the potential for change.

THE SHIFT IN TAX POLICY

Since the overhaul of the incentive regime in the Income Tax Act (Canada)(the ITA) for charitable donations began in 1996, successive Liberal and Conservative governments have marked out the parameters of our system in a remarkably consistent fashion. The big story: government is encouraging greater public benevolence. The main plot: the introduction of tax incentives to encourage gifts of assets—typically capital property—not
income. The system now provides the greatest incentive to donors of exceptional, not everyday, gifts. The underlying assumption of these incentives is that they should encourage more incremental giving, not subsidize existing giving with greater tax benefits. The last time there was a benefit for the ordinary donor was in 1994, when the first-tier federal tax credit was reduced from $250 to $200 (which provided a maximum benefit of $7 per taxpayer). According to Statistics Canada, in 2007, the median amount of donations claimed by taxpayers in Canada was $250, which provides a useful benchmark amount to define what I will call the “ordinary donor.” The new asset-focused incentives were intended to provide access to untapped pockets of wealth (or, at least, pockets of wealth that had only been lightly tapped).

Generally, this policy has been very successful, prompting unprecedented large gifts and increasing overall giving by 140%, from $3.6 billion in 1995 to $8.65 billion in 2007. By contrast, growth in the previous ten years was 24%, from $2.7 billion in 1985 to $3.6 billion in 1995. It has also generated significant debate within the charitable sector, especially as the number of taxpayers who reported donations dropped from 30% in 1990 to 24% in 2007. While there has been insufficient research, possible reasons may be donor alienation or the well-documented, widening gap between rich and poor. Whatever the contributing factors, the trend is worrying.

To put tax policy in colloquial terms, the pre-1996 donation incentive regime implicitly was designed with a model donor in mind. This individual regularly attended a religious institution (undoubtedly a Christian church) and tithed a percentage of annual income. The donation contribution limit—the amount of donations that can be claimed against annual net income—was 10% until 1972, and was then expanded to 20%. Even at death, the 20% contribution limit applied, which meant bequests that were large relative to income on the final two lifetime returns were only partially offset. The assumption was that charitable giving was a worthy activity but of limited public benefit. Charities were clearly subservient to government in the public hierarchy, and charitable giving was no replacement for paying taxes.

Prior to 1996, the Act did not overtly encourage individuals who wished to donate capital property, although there were opportunities for those who received good tax advice. There was one formal mechanism for gifts of capital property that came with the introduction of the capital gains tax in 1972. This was an election provision to enable donors to reduce the value of the tax receipt to between the adjusted cost base and the fair market value. This election helped donors of capital property who triggered a larger tax liability than they were able to offset with the 20% contribution limit [initially s. 110(2.2) and ultimately s. 118.1(6)]. A mechanism from 1977 encouraged donations of cultural properties, art and artefacts of national significance, which eliminated capital gain and enabled a 100% contribution limit for lifetime gifts.

By contrast, the post-1996 system appears to have a different model donor in mind. This donor is capable of making stretch gifts. The goal is to convert the annual donor, whether middle-class or wealthy, into a large-gift donor by encouraging him or her to donate capital. In this scenario, the model gift was publicly traded securities. With the longest sustained bull market in world history in 1990s as a backdrop, public securities brought spreading affluence to select parts of society. The reduction and ultimate elimination of
capital gains on gifts of public securities took root in this affluence by providing taxpayers with a way to combine their giving goals with tax planning. Dependent upon market value and personal timing, the new gift is typically exceptional, not annual or recurring. It is not something given exclusively on Sunday.

With the increase of contribution limits to 75% of net income during life and 100% at death, Canadians could now give and claim much larger gifts. For example, let’s consider a donation of public securities that is equivalent to 60% of the donor’s net annual income. After 1997, the donor could claim the full donation against income in a single year; after 2006 she could also eliminate all capital gains tax on the disposition. Pre-1997, the gift would have taken three years to claim, and there would have been no reduction in capital gains from the disposition.

Naturally there is a tendency to characterize this new donor as wealthy, which, in relative terms, is true. There is no question that the new regime has enabled the advent of multi-million dollar gifts in Canada and the attendant industry of “major gift” fundraising and charitable gift planning. The less-well-publicized story is the number of middle-class donors, aged 65 and over, who have changed their giving habits due to the new rules. Relative to other age groups, individuals aged 65+ have more assets, fewer debts, and statistically give more. The pre-1996 model donor has not been disadvantaged by the new regime, and, in many cases, has learned to donate from assets to receive additional tax benefits. Many charities have told me about loyal donors, often retirees, who had previously donated less the $250 per annum increasing their giving to $10,000+ through stock gifts. As long as markets remained buoyant, some of these donors even began to give at these new higher levels on a recurring basis.

The shift in charitable tax policy also represents a significant underlying shift in social policy. Since the development of our system of social services and healthcare in the 1960s, Canadians accepted that our primary way of funding social priorities was through taxes and government. This was implicit in a system where the maximum contribution limit for charitable donation was 20% both during life and at death. With the increase of the contribution limit to 75% for lifetime gifts and 100% at death in 1996 and 1997, the whole philosophy of the system subtly, but radically, changed. The increased contribution limits implicitly signalled that charitable giving is no longer a supplementary public benefit activity of lesser importance than direct government programs. Now, for Canadians who gave gifts that were large relative to their net income, charitable giving was a means to direct their contribution to society. In some situations, a taxpayer could choose to give to charity and not pay any taxes due to the contribution limits. True, they pay more to direct their own contribution to society through charity, but the option exists, and exists to an extent that makes Canada unique in the world.

If the tax numbers are to be believed, for the first time registered charities are considered to be as valid and as important a deliverer of public benefits as government. Simultaneously with this tax-policy shift was a general move from a state that provided universal benefit through a central command system to a state that attempted increasingly to promote desirable behaviour through taxpayer incentive. Especially under the Conservative government we have seen more policies that promote taxpayer choice and individual benefit: tax credits and incentives for fitness programs for children, education savings,
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public transit and, most recently, home renovations. The charitable contribution limit increase remains the most significant incentive in this regard because it can enable the 100% redirection of a citizen’s contribution from the state through taxes to charities through gifts. To this day, I am not entirely sure that the government was conscious of the policy implications of the increased contribution limits. The ITA implicitly says charities are as important as the state in terms of delivering public benefit. However, this attitude is not reflected in either government commentary or regulation of the sector. Not surprisingly, given the number and variety of registered charities in Canada—and the history of abusive tax shelter arrangements by a few charities—government confidence in the sector is qualified.

LARGE VERSUS SMALL CHARITIES

One of the persistent criticisms of current charitable tax policy is that it benefits large charities, often in the major urban centres, rather than small and rural charities. In 2001, for example, when the federal government reviewed the then-temporary 50% reduction in the capital gains inclusion rate for donations of public securities, a key test was demonstrating the benefit to small and rural charities. The perception is that only larger charities have the infrastructure, expertise, and donor base to receive significant donations. While it is unpopular to admit it, the dominance of large charities is a reality of the sector, despite the incredible vigour and success of many smaller entities. The landmark National Survey of Non-Profit and Voluntary Organizations states that:

A small number of organizations [charities and not-for-profits] account for the overwhelming majority of all revenues. One percent have annual revenues of $10 million or more; they account for 59% of all revenues received. In contrast, 42% of organizations have annual revenues of less than $30,000; they account for just 1% of all revenues. Less than 3% of organizations report having no revenues.

We speak of the sector as if it embodies the diversity and vigour of civil society, enabling community participation thorough a wide variety of registered charities, yet the ideal is typically ahead of the funding. The harsh economic reality is that, for the most part, small public charities don’t receive large gifts and no tax policy will change this fact. Charity capacity reinforces donor confidence. Donors who give their life savings to charities want to be sure they are well managed. Assets are always treated more conservatively than income.

Charitable donations are a form of social funding with particular limitations. To economists and social finance proponents, donations are too often motivated by emotions and parochialism, not efficacy. If we look at the entire voluntary sector, there is no question that there is a need for other social funding methods such as social enterprise models, earned revenue, and additional direct government funding to provide a balanced system. But giving does provide an essential source of funds for the sector, and it does reach broadly, even though the distribution is uneven. To address capacity issues, philanthropists have traditionally concentrated resources and charities have employed funding and management structures (foundations; national charities in health and religion) for the benefit of smaller operating entities (charitable organizations). Intermediary charities—such as community foundations, private foundations, and federated appeals—are key structures within the charitable sector to fundraise and manage resources. But these
structures are rarely cited during the debate on the distribution of charitable donations within the sector. Are they inherently unfair or just practical? To use an analogy, nobody argues that it is unfair that an owner of a local restaurant can’t get funding through capital markets, yet we persist in promoting the myth that the minimal support received by the vast majority of charities is solely a matter of access and equity.

Equitable distribution of funds within the charitable sector also has another dimension. From discussions with federal government officials over the last decade, I have heard public servants and politicians weigh the increase in expenditure on charitable tax incentives with what they perceive to be a corresponding loss of control over spending. The fear is that more incentives will lead to a reduction in the ability of the state to influence public policy and use of “public” funds. One of the most paradoxical and least noticed effects of the post-1996 incentives is that they enable the federal and provincial governments to influence donor choices through targeted matching fund programs. These matching programs began to be introduced in the mid-1990s. Major gifts are matched or leveraged through a variety of programs. Donors respond enthusiastically to leverage that increases the benefit of their contribution.

Federal matching programs such as the Canada Innovation Foundation, Genome Canada, and the Natural Areas Conservation Program are influential in aligning significant donor dollars with government priorities. Provincial programs in education and the arts, among others, have also been effective in influencing donor decisions. More subtly, direct funding of hospitals, universities, the arts, social service agencies, and international development organizations (through CIDA) help create the capacity and confidence that supports successful fundraising. Religion and philanthropic foundations are two major categories left out. This is the unseen hand of government in the Canadian system. It guides many (but not all) charitable donations to the priorities supported by government. In particular, these programs encourage gifts of assets for endowment and capital.

Thankfully, donors may support any registered charity they wish, but the donor that is completely independent of the influences of government money in the sector is in the minority. While elected officials and public servants may fret about loss of control over public expenditures, the truth is that the system is not neutral: it supports large institutional entities over small independent entities through a web of direct and indirect support programs. This web of government support seems to be little understood by the tax policy architects because there is little or no research connecting direct expenditure programs with the cost of charitable tax incentives. Governments have far greater influence over donor decisions than they realize, and they are not using this sway to support small and rural charities.

PARAMETERS

Successive Liberal and Conservative governments have developed a remarkably consistent series of themes in the Income Tax Act that have come to define giving and charity regulation in Canada. We have borrowed ideas from other jurisdictions, especially the U.S., but over time we have defined a distinctly Canadian way of encouraging and regulating charitable giving. The following is a short thematic analysis of donation tax incentives in Canada with the hopes of sketching out the parameters of our system. The summary is intended to illuminate the underlying philosophy of the Canadian system.
rather than provide a detailed technical description of individual incentives. Once I have outlined the parameters, I will examine where the potential for change may lie.

There are seven key markers defining the parameters of our system:

1. tax deductions and credits;
2. capital gains relief;
3. lack of income incentives;
4. self-dealing provisions;
5. conservative valuation;
6. contribution limits; and
7. equal treatment of charities.

1. Tax deductions and credits

The core charitable tax incentives in Canada are tax deductions and tax credits. Individuals receive non-refundable credits, which are subtracted from the tax otherwise owed. Corporations receive deductions, which are subtracted from gross income. Both deductions and credits are tax offsets. In simple terms, when you make a donation to a charity in Canada, you get your tax back.

An individual donor in British Columbia who makes a cash donation of $1,000, for example, would receive 43.7% combined federal and provincial tax credit (assuming she gave other donations of at least $200 during the year). The cost of this donation would be 56.3%. The 43.7% tax credit is equal to the highest marginal tax rate in B.C. Bottom line: a charitable gift impoverishes the donor. This is a basic principle of charitable giving and tax policy.

There are a number of subtle and not so subtle exceptions to the tax-offset rule. The subtle exception is due to the tax credit, which replaced the deduction for individuals in 1988. A tax deduction is taken off the top, reducing gross income and therefore producing tax savings equal to the average tax rate of the donor. Hence, a donor who pays a 29% average tax rate would receive a 29% tax deduction for a donation; a donor who pays 46% would receive 46% in savings. By contrast, a credit is claimed against annual net income (after deductions), and may have a higher or lower value than the average tax rate. In Canada, the federal portion of the non-refundable charitable credit is tiered, with donations under $200 getting a federal credit of 15% and amounts in excess 29%. Add in the provincial tax credit, and it is normal to have all donations over $200 receive tax credits equal to the highest marginal rate in most provinces.

Few taxpayers understand that the charitable tax credit provides a special incentive to generous low- and middle-income donors. Generous middle-income donors may, for example, pay an average tax rate of 32%, but they could receive a combined federal and provincial tax credit of between 40% and 50% depending on their province of residence. Rather than a mere tax offset that high income donors receive with their tax credits, middle- and low-income donors can receive a bonus incentive for giving, if they give more than $200 annually. This benefit is rarely factored into the discussion about tax benefits for the “ordinary” donor.
Despite the extra advantage provided by the tax credit, the principle of tax offset is well entrenched in the Canadian system. As federal officials have explained over the years, they view the system as a 50/50 partnership between government and the taxpayer to support charities. This is an analogy they persist in using despite lower tax rates introduced in the late 1990s.

2. Capital gains relief

Capital gains relief is a more recent addition to the system than deductions and credits. In conjunction with contribution limits, capital gains relief is the one of the two primary mechanisms designed to encourage gifts of capital property. It was first introduced as a mechanism in 1977 with the exemption for cultural properties. It has been applied more broadly after the one-half elimination of capital gains on publicly traded securities in 1997. The complete elimination of capital gains on gifted property did not occur until 2006. Capital gains relief is a second-tier giving incentive. It is always used in conjunction with the basic offset benefit, the deduction or credit.

Exemption from capital gains now applies to public securities, ecologically sensitive land (including easements and covenants), private exchangeable securities, and cultural property. In addition, donations of public securities purchased through employee stock options are also exempt from tax triggered by the exercise if the donation is made within 30 days. Technically, options are income, not capital but, like capital property, they are taxed at 50% of normal income rates. In most situations, the property must be donated “in kind” in order to eliminate capital gains.

Capital gains are currently taxed at 50% of the normal tax rate. Hence, in Ontario the capital gains rate is 23.2% or half the highest marginal rate of 46.41%. The value of the tax benefit depends upon the amount of the capital gain (the difference between the adjusted cost base and the fair market value). If the cost base is zero, the capital gains savings would be equal to the capital gains rate, but in practice the additional tax savings range from 5% to 15%. An Ontario taxpayer, for example, could receive a tax credit of 46.4% and a capital gains saving of 10%, for a total tax benefit of 56.4%. The variable cost of the incentive clearly helps make it palatable to the government.

The argument to eliminate capital gains has focused on removing the cost and psychological impediment of capital gains tax triggered by the gift. The cost at disposition prevented donors from giving capital property because they saw it as paying taxes to donate even though the capital gains would have been offset by the credit or deduction. The sector argued that getting rid of the tax cost at the time of donation would unlock a class of assets not previously donated to charity in significant numbers. The incentive has also helped to inform taxpayers that these assets are potential sources of donations. In summary, it opened up a fresh source of donations, changing donor behaviour and increasing the value of total donations.

For example, to November 2008 “over 678 eco-gifts valued at over $417 million have been donated across Canada, protecting 117,190 hectares of wildlife habitat. More than one-third of these eco-gifts contain areas designated as being of national or provincial significance, and many are home to some of Canada’s species at risk.”5 According to a
survey compiled by the incentive’s primary champion, Donald K. Johnson, it is estimated that donations of public securities have totalled over $3 billion since 1997. These incentives have been proven to be effective in increasing incremental giving and changing donor behaviour.

3. Lack of income incentives

Building on the principle of tax offset, the ITA does not provide any extra incentives for significant tax events involving income. The best example would be a withdrawal of funds from a registered retirement saving plan (RRSP) or registered retirement income fund (RRIF). Withdrawals from these widely held plans are taxed as income, not at the 50% capital gains rate. Another example would be recapture of capital cost allowance on depreciated commercial real estate or non-arm’s length employee stock options. It has been suggested in some circles that a donor should receive an exemption from the income tax upon withdrawal, in addition to receiving the regular credit. In effect, this could mean a 46% credit and a 46% income exemption, for a total tax benefit of 92%. Needless to say, this would be a rich incentive. Unlike the variable capital gains exemption, an income exemption would have a fixed and high cost for government. There appears to be an appropriate tax benefit for philanthropic gifts that our system will tolerate, and an extra incentive for income is beyond that limit.

4. Self-dealing provisions

As Ottawa introduced incentives to increase giving, there has been a corresponding tightening of the self-dealing or non-arm’s length rules. This began with the non-qualifying securities and loan-back rules introduced in the 1997 budget that focused on preventing donations where the donor and the charity are non-arm’s length (for example, the donor is a director of the charity or a private foundation is family controlled and funded). These rules closed down well-developed methods for giving wealth in private companies to charity, especially to private foundations. Since 2006 and 2007, private foundations have been subject to the elaborate Excess Business Holding Regime (EBHR), which targets large holdings of public and private securities in private foundations. The EBHR was a direct and unintended response to the sector’s request to expand the elimination of capital gains for public securities to private foundations. Federal policy makers have attempted to shut down any business dealings between charities and non-arm’s length persons.

These rules have lopped off the creative margins of giving and planning to enrich the mainstream of giving and planning, which was perhaps their purpose. The mainstream is characterized by arm’s length transactions, public governance, and no tax benefits for any arrangements where there is seen to be self-dealing. It also made the ITA prejudiced against taxpayers who grow and hold their wealth in private companies. Rather than implement a regulatory regime that emphasizes charitable benefit, the tax system assumed that non-arm’s length transactions were in conflict with charitable giving and that the donors who engaged in such transactions were suspect. There have been grave and justifiable concerns expressed about this trend by commentators. Nonetheless, it is a policy theme that has become entrenched within the ITA.
5. Conservative valuation

The Canadian system has simple valuation rules for in-kind gifts and is sceptical of third-party professional valuations. The value of an official receipt for income tax purposes is determined by fair market value—what a willing buyer will pay to a willing seller—but increasingly the ITA has prescribed how that value is determined. Public securities receive special tax treatment because, in most cases, the public markets provide transparency and certainty of valuation. When valuation is more complex, the Canadian system has either introduced bureaucratic regimes that provide oversight of professional value or deems fair market value based on the nature of the donated asset. Underlying the entire system is the anxiety that gifts will be overvalued and the taxpayer will receive excessive benefit at the expense of the fisc and the recipient charity.

There are a few examples of deemed value. Non-qualifying securities (typically private company shares owned by a non-arm’s length donor) cannot be receipted unless the property is disposed of within 60 months (five years) of the donation. At that time, the sale value of the shares becomes the receipt value, not the fair market value at time of donation. The “deemed fair market value” rules in s. 248(35), an anti-tax shelter rule provision, set the receipt price as the purchase price if the property was acquired within three years of the donation (this particularly applies to moveable property, such as art and pharmaceuticals, as well as foreign real estate). The value of donations from stock options are deemed using the exercise price of the option, regardless of whether the gifts are transferred as shares or cash proceeds of the exercise. A gift must be made within 30 days of the exercise for the extra incentive to apply [s. 110(1)(d.01) and 110(2.1)].

The use of a valuation bureaucracy is also well accepted. The valuation regimes for ecologically sensitive gifts and cultural property require approval by government bodies (Environment Canada and the Canadian Cultural Property Export Review Board). Public securities, by contrast, primarily enjoy special tax status due to the transparency of valuation that the public markets provide.

The Canadian approach is in contrast to the U.S. charity regime, which has detailed rules for valuing gifts of real estate, private company shares, and charitable remainder trusts in the Internal Revenue Code. Most of these rules rely upon the professional expertise of third-party valuators, who are subject to civil penalties for professional negligence or deliberate misrepresentation. The Canadian system has far less faith in independent valuations and is reluctant to provide clear guidance on certain types of valuation (where have all the Canada Revenue Agency (CRA) Interpretation Bulletins for charitable giving gone?). After years of dealing with art flips and donation tax shelters, Ottawa fears valuation abuse and inflated receipts. The ITA increasingly converts the value of in-kind gifts into their cash worth.

6. Contribution limits

Contribution limits regulate how much a taxpayer can donate and claim against net income in any given year. The Canadian system is more generous than any other regime in the world, with limits of 75% during life and 100% at death. The Canadian system is also simple, as these rules apply to all gifts to all types of qualified donees, to all donated
property, and to both individuals and corporations. By contrast, the U.S. employs lifetime tiers ranging from 10% to 50% to reflect a hierarchy of recipient charities, donors, and different types of property being donated. Also, the U.S. system limits corporate donors to making gifts equal to a maximum of 10% of income in any given year, which skews giving towards the individual. A related measure in the Canadian system is the five-year carry-forward for gifts donated during life and a one-year carry-back for gifts made at death.

Contribution limits assist exclusively the exceptional donor who makes gifts that are large relative to income. The generosity and simplicity of the Canadian system is, to my mind, insufficiently appreciated relative to credits/deductions and capital gains offsets. Moreover, contribution limits are the one incentive that put charitable giving on a footing almost equal to that of paying tax within the system. True, few donors test the upper contribution limits, but the fact these limits exist makes it clear we have a system geared towards the exceptional donor who contributes capital.

7. Equal treatment of charities

Generally, the ITA treats donations to all causes within the charitable sector equally for tax purposes. For example, a donation to a church in Flin Flon, Manitoba, receives the same tax treatment as a donation to a university in Montreal. The system is cause agnostic.

There are a few exceptions to this rule. The aforementioned eco-gifts and cultural properties programs target special classes of assets of national importance, which only certain charities are capable of protecting. Universities receive some tax privilege. Domestic universities can receive and receipt donations from U.S. alumni and their families under the Canada-US Tax Treaty. International universities can be qualified donees in the Canadian system under Schedule VIII of the ITA. Also, there are distinctions among the three types of registered charities in the ITA, particularly private foundations, but these legal structures have nothing to do with cause and everything to do with governance and funding. There are examples of the government temporarily targeting a specific cause. The most notable example of this was the extension of the donation year in 2003 to include gifts to charities addressing the Southeast Asian tsunami.

Tax incentive equity among causes is a noteworthy feature of the Canadian tax system. Consistent tax benefits for charitable gifts are the single factor that all charities can depend upon. While sub-sectors have requested special treatment of donations to specific causes in Canada—there were a number of initiative discussed last fall in the midst of the economic crisis—they have been rebuffed. This even-handedness is an important principle that helps protect certain types of charities from government bias. Priority areas are supported through direct government investment, not tax charitable tax incentives.

SUMMARY

Taken together, these seven policy markers or themes reveal a tax system that has been remarkably consistent in defining our system of charitable incentives. While there is no question that certain planning avenues have been shut down and some classes of donors discriminated against—most notably private business owners—the parameters of the
system have become set. Any proposal for new tax incentives needs to be presented in consideration of this system. While it may be possible to push the boundaries—especially on a trial basis—to achieve certain clear policy objectives, I question the success of any policy proposals that do not work within these parameters and build upon the precedents within the ITA.

POLICY OPTIONS

Having outlined the parameters of charitable tax system, let me return to the opportunity we may have to take advantage of the current economic situation to advocate for new incentives. As mentioned, there are a variety of perspectives on the need and nature of any new incentive for charitable giving. The debate in Canada around charitable incentives is defined by three positions:

1. We have enough incentives; giving is less important than other forms of revenue, such as government funding and earned income.
2. We need to build the base of donors and stimulate giving from ordinary Canadians.
3. We need to encourage greater incremental funding for the sector by removing additional barriers to give capital assets.

A fourth policy position is to develop measures to promote social entrepreneurship and social finance, such as the UK’s hybrid structure, the Community Interest Company. Without undermining the importance of further direct public funding or social entrepreneurship—both of which I believe is of central importance to society—I will contain my comments to new charitable incentives. This means focusing on the debate between measures for ordinary donors and extending the incentives for gifts of capital.

INCENTIVES FOR ORDINARY DONORS

At least two budget proposals in January focused on increasing the tax benefit of donations from income by the ordinary donor. After consultation with a cross-section of national charitable sector leaders, Imagine Canada made a proposal for a temporary “stretch credit” of up to 50% federally for new gifts of up to $15,000 to encourage additional giving for a three-year period.7 Cardus, a Calgary-based Think Tank, proposed an increase in the federal charitable credit from 29% to 42% for gifts over $200.8 Even the Canadian Council for Chief Executives urged the government to increase tax credits for donations as part of its more broad-based submission. In the background, there was ongoing discussion within the sector on the possibility of eliminating the $200 first-tier on the federal tax credit, although to the best of my knowledge this idea was not championed publicly.

There are a number of issues relating to the effectiveness of providing enriched tax incentives for giving that are useful to explore in greater detail:

1. giving levels,
2. the effect of tax savings on the ordinary donor,
3. the Alberta example,
4. cost/benefit analysis for government, and
5. the perceived value of tax credit.
1. Giving levels

As mentioned above, the number of taxpayers who reported donations dropped from 30% in 1990 to 24% in 2007, which has caused considerable and justified concern within the sector. There may, however, be some material factors underlying the tax data. What is less well known is that 25% of taxpayers claimed donations in the early 1980s. This rate climbed with the strong economy in the latter half of that decade and the widespread adoption of computer-supported fundraising technologies, such as direct mail and telemarketing. Although I am not aware of any research making this connection, I suspect the repeal of the $100 standard deduction in 1985 encouraged many taxpayers to claim donation deductions for the first time. The decline in the number of tax filers has been most pronounced in the 2000s, which is when electronic filing of tax returns increased to the point where close to 50% of taxpayers filed in this way. Most tax software programs combine giving by spouses to circumvent the first lower tier of the federal tax credit. This turns two donors into one for statistical purposes. While I am not suggesting that the decline in taxpayers is not real or of concern, I do want to point out there are other factors that influence giving statistics apart from donor engagement and the cost of giving.

2. Effect of tax savings on the ordinary donor

Whatever the underlying reasons for the decline in donors, the material question is, Can it be reversed through tax policy? Probably not. Taxes incentives have little or no effect in encouraging modest gifts from cash flow. Fundraising research supports this assertion. Altruism, beliefs in the charity’s mission, and the circumstances of the solicitation have a greater effect than tax incentives on securing gifts. When a friend asks you to support her weekend walk for breast cancer, you do not calculate tax benefits of your decision. This is typical philanthropic behaviour, and it extends to most routine forms of giving.

Does increasing the basic tax deduction or credit encourage the ordinary donor to give more? I would argue that it does not in a way that justifies the additional government expenditure. There is a significant body of philanthropic research, especially from the U.S., that places charitable incentives at or near the bottom of motivating factors for giving. As the average size of the gift shrinks the importance of tax as a motivating factor declines. Other factors increase, especially belief in cause, trust in charity, nature of the solicitation, and identity of solicitor. Most people, when deciding to give a $25 or $100 donation, think first of the cause and the social and personal circumstances of the solicitation.

Surveys show that between 78%23 and 81%24 of Canadians make cash donations to charity each year. This compares with the 2007 donation rate of 24% among taxpayers. Most of these donations by volume are not claimed on tax returns, either because they are not receipted or the donors don’t bother, which suggests that tax data is a limited generosity index.

3. The Alberta example

The discussion about increasing the tax credit has undoubtedly been informed by the province of Alberta. In its 2007 provincial budget, Alberta increased the provincial do-
nation tax credit from 10% to 21%. Alberta donors who give more than $200 annually receive a 50% tax credit—even though the provincial highest marginal rate is 39%. This bonus incentive was labelled the Community Spirit Program and was paired with a donation-matching program to encourage higher levels of giving to Alberta charities. In some cases it has become cheaper to make donations than to pay taxes. It is also the most dramatic experiment in Canadian history to encourage additional giving by departing from the tax-offset model and introducing an active incentive or subsidy for giving.

So what has the Alberta experience been in increasing giving through these measures? Statistics Canada data shows that the number of Alberta taxpayers claiming donations increased by 0.2% between 2006 and 2007, although the value of donations increased 7.3%. These numbers were the second best in 2007 after B.C., which had a 0.5% increase in donors and 7.5% increase in donations. B.C. did not have an extra charitable incentive, nor did it have the hottest economy in the country. While this is insufficient data, it illustrates the limited influence of tax incentive on the average donor making average donations. (In Alberta, the median donation was $350 in 2007. As discussed, the median in Canada was $250, largely due to the deflationary effect of Quebec, which had a median of $130.)

The province’s experiment was a result of budget surpluses and record high-energy prices. An Alberta colleague tells me a number of factors independent of the charitable sector influenced the Community Spirit Program: Alberta’s large fiscal surplus, the inability to lower taxes any further due to backlash from other provinces, and the desire to redistribute tax revenue without reverting to “Ralph Bucks” (cheques to taxpayers). Now that Alberta is again posting a provincial deficit due to declining energy revenue, this experiment in charitable tax policy is probably under review.

4. Cost/benefit analysis for government

The government’s reluctance to provide greater tax savings for ordinary donors is rooted in the fear of fiscal waste and insufficient economic return. There are two risks in trying to use tax measures to encourage greater giving by the ordinary donor. First, the fisc would pay more for existing donations. Second, the cost of encouraging new donations would not justify the expense. The view appears to be that the focus on tax incentives for gifts of assets provides a better return on investment. This argument, as would be expected from the Department of Finance, is fiscal and does not appear to consider the significant public benefits of encouraging greater civic participation through support of charities. A disadvantage of having such a generous regime to support charitable giving is that it produces an over-reliance upon tax measures to produce public benefit and encourage civic participation. We put too much faith in tax incentives to spur giving and have become blind to the other factors that affect donor behaviour and generosity.

Greater tax incentives can unbalance the system, increasing government expenditure without a corresponding increase in dollars to the community. For example, it is possible to estimate the cost of eliminating the first federal tax credit tier moving it from 15% to 29% for the first $200 in donations. We know that the donation tax credit cost $2.65 billion in 2007. We know that the median donation was $250 and that there were 5,698,880 taxpayers claiming donations. We know that the current sys-
tem provides a tiered federal tax credit: 15% on the first $200 in total donations and 29% on amounts over $200. Assuming 60% of donors or 3,419,328 Canadians gave at least $200 in total gifts, we can extrapolate that eliminating even the first federal tier would cost at least $198,321,024 versus the current $102,579,840. That’s an increase of government expenditure of $95,741,184 to support existing giving at the base level. There are probably better ways to spend $95 million in the charitable sector.

Other proposals focused on increasing the credit are similarly expensive. For example, the Cardus proposal made in January 2009 projected a cost of between $400 and $600 million to the federal government.

5. Perceived value of tax credits

Many generous low and middle income Canadians actually get significantly more tax savings for their donations than taxpayers in the same income bracket in the U.S. But that is not the perception in Canada, partly due to the confusion that stems from the 1988 move from deductions to credit for charitable donations. As outlined in the discussion on deductions and credits above, the credit system provides an extra tax incentive for the generous donor who is not taxed at the highest marginal rate. The generous donor can receive higher tax savings from a donation than his or her average tax rate.

The problem with the credit system is not value and equity, but clarity. Few taxpayers understand the benefit they are receiving, or would be receiving if they gave more. This is partly due to fact that the credit is two-part: a federal credit of up to 29% and provincial credits that vary in value depending upon the province. Unless taxpayers get information from their advisors, they likely have no clear idea of the value of the donation being claimed. The Canada Revenue Agency offers no such guidance. The T1 return for individuals explicitly states only the federal credit and shows no provincial tax savings. This opacity creates no end of confusion among taxpayers about the full benefit of giving. There are undoubtedly better ways to communicate the value of the credit to donors, which would perhaps provide them with the confidence to give more to charity.

INCENTIVES FOR EXCEPTIONAL GIFTS

In contrast to the ordinary donor, the donor of exceptional gifts has proven easier to influence through tax benefits. The stakes for charities and the government, however, increases with capital donations due to their size and complexity. In January 2009, Donald K. Johnson, special advisor at BMO Capital Markets and the driver for the elimination of capital gains on gifts of public securities, developed a proposal to eliminate capital gains on gifts of real estate and private company shares. I provided technical mechanisms for the proposal. These proposals were designed to unlock the two largest remaining asset classes in the country for the purposes of charitable giving. They were structured to fit within the parameters of the system that I have outlined.

Gifts of real estate

Eliminating capital gains on appreciated taxable real estate is complex due to the liability and administrative issues associated with real estate. We proposed two methods
for charities to receive gifts of real estate that would be capital-gains exempt. In the first method, the qualified donee would receive all or part of the cash proceeds from a sale of the property. This method involves a donation of cash proceeds from real estate sales and deeming rules to eliminate capital gains. The second method is an in-kind real estate donation and would enable the qualified donee to retain the property for use within its mission.

The underlying practical issue with gifts of real estate is that most charities do not want to own the donated property but want only to receive the cash that might derive from its sale. Hence, the best solution is to create a provision in the ITA that makes the donor responsible for the sale of the real estate and establishes valuation of the gift as a matter of fact rather than estimation.

Currently, ordinary in-kind donations of real estate in Canada are most commonly used by charities to advance their missions. (Ecologically sensitive land donations are also used directly for mission, but have a separate tax treatment and regulatory structure.) An example of an ordinary real estate donation with direct mission application is land for a church or for social housing. In-kind mission-related real estate donations are important to charities and need to be accommodated in any new provisions.

Traditional in-kind donations of real estate to charities raise numerous red flags. These include valuation, costs associated with transfer, and complexity and potential liability for charities after receipt. The U.S. has created a regime that focuses on in-kind real estate donations bolstered by extensive valuation regulations and a bureaucracy, which do not fully address the issues of valuation, cost, or complexity associated with these gifts. The U.S. emphasis on donation valuation rules has no precedent in the Income Tax Act (Canada). The U.S. in-kind system is also not designed for small charities, and even large charities struggle with property management issues, costs, and environmental liability.

A. DONATIONS OF CASH PROCEEDS OF A REAL ESTATE SALE
The precedent exists within the ITA to sell certain property to fund a donation—and to eliminate tax on disposition—as long as the property is donated within a certain period of time. Gifts of public securities acquired under a securities options plan per subsection 110(1)(d.01) must be donated within 30 days of exercise to eliminate capital gain. Moreover, subsection 110(2.1) provides the ability to donate all or part of the proceeds of disposition to a qualified donee if the gift is made within 30 days of the tax event. In practice, subsection 110(2.1) means the donor is responsible for exercising the option, selling the acquired securities, donating the cash within 30 days, and reporting the extra deduction (on line 249 of the T1). The donor is required to ensure there is an audit trail for the flow of funds. The charity receives the cash and is not required to annotate the official receipt for income tax purposes with details about an in-kind donation.

These existing provisions are useful because they enable donations of partial proceeds of disposition of valuable property and address the cost of acquisition (exercise price of the option). The tax is pro-rated on these transactions: the gift portion is exempt from employment income, and the amount retained for personal use is taxable at normal rates. This ability to pro-rate tax is helpful when donating real estate as it enables the property to be divided and for mortgages to be addressed. The charity would not need to manage
mortgages or, in split-receipting scenarios, enter into complex arrangements with the donor to repay a portion of the ultimate sale price.

The current split receipting provisions in 248(31) and 248(32) support this approach. For example, a property has a fair market value of $250,000 and an adjusted cost base of $50,000, as well as a mortgage of $25,000. The owner could sell the building and donate $100,000 of the cash proceeds to charity, eliminating 2/5 of capital gains. The balance of capital gains calculated on the amount retained for personal use and retiring the mortgage would be taxable at the normal rate.

With real estate where the capital cost allowance has been claimed—for example, a multi-unit residential rental property—a sale will trigger recapture of the depreciation and force inclusion in the donor’s income. While the recapture of the capital cost allowance is sometimes a greater cost at disposition than the capital gain, we thought it would be inappropriate within the parameters of the ITA to introduce a new provision to forgive recapture. There will be sufficient credit or deduction to offset recapture, although it will reduce the tax effectiveness of the gift. Provisions in subsection 118(1) on “total gifts” and depreciable property address the potential mismatch of tax liabilities and deduction due to contribution limits. We propose that this contribution limit provision apply to any new rules for real estate, whether the gift is made in-kind or with cash proceeds of a sale.

**B. IN-KIND, MISSION-RELATED REAL ESTATE DONATIONS**

A taxpayer willing to make a gift of real estate for use or occupation by the charity related to its charitable purposes should not be penalized with the introduction of a new tax incentive. Clear rules are required, however, to prevent abuses that may be caused by increased tax benefits. These rules would be consistent with mortmain rules that exist in some provincial legislation, such as Charities Accounting Act in Ontario. Analogous provisions also exist for donations of cultural properties, which must be held for a minimum of ten years or the charity faces a special tax equal to 30% of fair market value of the property at the time of disposition.

We recommend the following restrictions be introduced into the Act to enable exempt in-kind donations:

- The qualified donee must hold the real estate for a minimum of ten years.
- The real estate must be used directly for charitable purposes or, in the case, of non-charitable qualified donees, mission (for example, a storefront for a social service agency or land for a school).
- The gift should be subject to a written agreement between donor and charity.
- The real estate cannot be held for investment purposes, even though income could be used for mission.
- Intermediate sanctions could be applied to the qualified donee for failure to respect the terms of the gift.

The two-part proposal to encourage gifts of real estate would apply to investment properties and vacation properties, and commercial and industrial real estate. Principal resi-
dences, which are tax exempt, would naturally be excluded. Eligible donors would be individual and corporate taxpayers, and the real estate could be held in Canada or in foreign jurisdictions. Gifts of certified ecologically sensitive land or interests in land (through easements, convenants, or servitudes) to eligible qualified donees are exempt from this proposal.

**Gifts of private company shares**

Gifts of private company shares are addressed in subsections 118.1(13) to 118.1(20), which are known in the sector as the non-qualifying securities provisions. There are mirroring corporate provisions in 110.1(6). Since these sections were introduced in 1997, they have been proven to be effective at preventing self-dealing; hence, they are good candidates to be upgraded to eliminate capital gains.

These provisions define non-qualifying securities in terms of the donor’s relationship to the charity. If the donor is at arm’s length from the registered charity—whether it is a charitable organization or a public foundation—an immediate receipt for (appraised) fair market value may be issued. If the donor is not at arm’s length from the charity, then no receipt may be issued until the security is disposed by the charity within 60 months of the donation. Subsection 118.1(16) provides restrictions on loan-back transactions.

Per subsection 118.1(13), if the security is non-qualifying, the charity has 60 months (five years) to make the relationship with the donor arm’s length (public charities) or to “dispose” of the security (for private foundations). Disposition by the charity is typically for cash, and there can be no exchange of the donated non-qualifying security for another non-qualifying security. For tax purposes, the disposition value becomes the receipt value, not the fair market value of the security at the time of transfer. The disposition must occur within 60 months, or no receipt may be issued by the charity. Fortunately, the donor does not have to recognize the disposition of the security at the time the securities are donated to the charity, but the disposition occurs when the securities are sold within the 60-month period. If there is no sale of the securities within 60 months by the charity, the donor does not pay capital gains tax on the disposition. Valuation of the receipt is therefore determined by proceeds of the disposition—typically cash—received by the charity, which is designed to eliminate valuation concerns. Again, this method decreases administrative burden and risk for the charity. (The charity will still incur potential liability as a shareholder of certain classes of shares.)

Subsection 118.1(13) provides the framework for upgrading the tax benefit. Like the proposal for gifts of real estate, the tax receipt would be issued and capital gains eliminated only after the charity has received cash for the dispositions of the donated securities. Unlike real estate, the security would be first donated in-kind to the qualified donee and then be disposed of by the charity within 60 months.

Subsection 118.1(19) allows public charities—charitable organizations and public foundations—to provide a receipt for an in-kind donation of private securities without the need for monetization if the “taxpayer deals at arm’s length with each director, trustee, officer and like official of the donee.” Private foundations have greater restrictions. It would make sense to eliminate the arm’s length test and make the receipt dependent
upon monetization within the 60-month period. A single standard for both public and private foundations would limit potential abuse.

The proposals were designed to encourage significant incremental giving, expand the capital gains exemption in an equitable fashion, and provide valuation certainty. They were also structured to try to maximize ease of valuation and management for charities. However, the counter argument against these proposals is that they are not designed for broad-based giving. The vast majority of registered charities would find these proposals too complex to implement, even if they were fortunate enough to have donors who would consider them as beneficiaries. Although real estate and private company are widely held across Canada—perhaps more so than public securities—these assets are less well understood. While arguably of greater economic benefit to the sector than any incentive for ordinary donors, real estate and private company shares will primarily support small charities only through intermediate entities such as private or community foundations. This political tension between large and small charities that I have discussed will be a factor in adoption, regardless of public benefit and cost considerations.

**POLITICAL CONSIDERATIONS**

Even though the successive Liberal and Conservative governments have been remarkably consistent in developing our system of charitable tax incentives—in no small part due to the influence of public servants within the Department of Finance—the wild card in Canadian tax policy is the philosophy of the party in power. We have a clear framework to build upon. Nonetheless, there are political considerations in tax policy that are rooted more in ideology than in consistency or cost.

Stephen Harper’s Conservative government puts a strong emphasis on providing help to ordinary Canadians with direct tax benefits. This government has demonstrated a distrust of government programs and a faith that tax policy through a variety of credits, deductions, and reductions will encourage Canadians to make positive choices. The most noted example of this approach is the reduction of the Goods and Services Tax (GST) from 7% to 5%. Economists argue that reducing consumption taxes contributes little to strengthening the economy, doesn’t materially affect consumption, and will hurt tax revenue. The general view is that it is more effective to cut income and business taxes to stimulate consumption and production. The Conservatives, however, seemed to have been less interested in what the “experts” had to say and more influenced by the polls. This grassroots orientation shows a remarkable political savvy but a debatable result. This populist orientation may mean that increases to the core tax credit may be considered.

The charitable sector—rooted in volunteerism and community action—fits squarely within the Conservative worldview. There is also a demonstrated support for charitable giving in the 2006 and 2007 federal budgets, especially with the elimination of capital gains on public securities, eco-gifts, and exchangeable shares. The Conservatives took measures introduced by the Liberals in 1997 and pushed them to their natural conclusion. In the 2005 election the Liberals, who had defended their failure to eliminate capital gains on these gifts on using an analysis of taxpayer benefit, missed the political opportunity to finish the job they had started. Caught in a policy framework, the Liberals let the Conservatives become political heroes on the charitable giving front. The irony
is that Harper’s Conservatives have never articulated a vision for the sector, unlike the Liberals with their Red Book during the late 1990s. This lack of a clear policy for the sector provides political flexibility and a lack of predictability about the kinds of policies the government will adopt.

The other possibility is that our system of charitable incentives may be curtailed. I view this as a remote option, and mention it only because it is something that may be occurring in the U.S. at the moment. President Obama’s first budget in February 2009 proposes that taxpayers earning more than $250,000 will have their ability to deduct contributions to charities reduced to a rate of 28 percent from a rate of 35 percent. While many U.S. commentators have criticized this proposal, some fundraising commentators have observed that the effect on giving would be limited. The pendulum can swing the other way.

CONCLUSION

As a sector, we are conflicted about the issue of tax benefits and giving. Tax savings are not the great motivator, but they are the great enabler—especially as the size of the gift and income of the donor increases. The purists deny the role of taxes and the cynics celebrate it. The truth is somewhere in the middle. While modest gifts often occur without consideration of cost, major gifts from capital are shaped by mixed motivations: cause, charity, solicitor, altruism, public profile, and taxes. Tax savings also assist the thoughtful donor to budget larger sums for charity. The bigger issue is getting the right balance between altruism and tax benefit and between government and personal expenditure.

It is important to remember that a charitable donation is a values-based transaction. A gift in the classic common law iteration is “freely-given without consideration” and results in impoverishment. An increase in tax benefits for giving—whether it is to the basic tax credit or additional capital gains provisions—could be a form of benefit inflation that could potentially distort the system. At what point is the tax system training Canadians to expect a high subsidy to do the right thing? This is an ethical question that needs to inform the more pragmatic realm of economics and tax policy.

While we still have considerable room to expand and rationalize the charitable incentive regime, eventually we will have a mature system. Donors will be able to utilize the existing rules to maximum effect, but without the expectation of new incentives to sweeten the pot. We are not yet at that point, but it is useful to contemplate the day when further reforms will be focused on tinkering rather than structural expansion. Put another way, at a certain time the balance between tax support and philanthropy will be reached. Within a mature regime, increases in giving will become more dependent upon altruism, as well as economic and societal factors, and less upon increased tax benefits. It is a good ideal to work towards.
2 Statistic Canada.
3 Statistic Canada, Tables 111-0001 to 111-0003.
7 Imagine Canada, “Budget 2009: Short-term Stimulus Measures for Assisting Canadians and Communities during the Economic Downturn,” January 15, 2009 [I was part of the group consulted that prepared these recommendations.]
9 “Philanthropy Poll, May 2006,” Ipsos-Reid for Scotiabank Group; “Generational Differences in Charitable Giving and Motivation for Giving,” The Centre on Philanthropy, University of Indiana, May 2008, “Why Do People Give?” Paul G. Schervish and John J. Havens. The Not-For-Profit CEO Monthly Newsletter 5, no. 7 (May 1998): 1-3. The one exception is a recent poll by TD Bank Group/Angus Reid released in November 2008 that ranked the importance of tax savings first as a motivator for giving more. Of taxpayers with income in excess of $100,000, 58% said they would give more if tax benefits were greater. There is evidently a difference in philanthropic attitudes reflected in research focused on donors and broader surveys that include non-donors.