

Viewpoint

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THE 1981 BUDGET: FAILURE OF PROCESS?

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A discussion of the substantive proposals affecting charities under the November 12, 1981 Budget, and of the subsequent changes to these proposals, will be found elsewhere in this issue. This article will look at another aspect of the problem, the failure of the Department of Finance's process which resulted in proposals for radical and potentially disastrous tax amendments without the affected constituency being consulted.

Because the magnitude of the changes affecting charities can be compared only to the overhaul of the tax laws in the 1976 Budget, it is instructive to compare what happened prior to that Budget with what happened in 1981.

Prelude to Change: 1973-1976:

The major amendments to the tax laws which were announced in the 1976 Budget and which, for the most part became effective on January 1, 1977, had their genesis in a promise made years earlier by the then Finance Minister Edgar J. Benson. During the tax reform process of 1968-1972, Benson promised that a study would be undertaken on the definition of the term *charity*, with a view to "updating" the old common-law definition. Time constraints did not permit this to be done for the 1972 tax amendments, but a committee was struck in 1972 to look at the subject.

By 1973, the committee was effectively non-functioning and the bulk of the work was transferred to one person in the Department of Finance. The conclusion of that internal study was that any major change in the definition of a charity was impractical. But the study also pointed out that the tax laws dealing with charities were extraordinarily vague and there was a concern voiced that if charities desired, the tax system was subject to massive manipulation.

John Turner, who was at that time Finance Minister, authorized a more thorough study of the problem and requested that recommendations be proposed.

Throughout 1974 and early 1975, that study continued internally. When the study was completed, the conclusions were twofold. First, the Income Tax Act clearly offered extensive opportunity for tax manipulation under the guise of charitable activity. Second, notwithstanding the fact that opportunities were offered, it was not at all certain that such manipulation was in fact taking place, or if it was, the extent of the problem.

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The solution arrived at was to publish a “Green Paper.” In government jargon, such a paper contained proposals to which the government was leaning without in any way committing the government to follow through on its ideas. The game plan was to issue this paper with the 1975 Budget and request submissions from concerned organizations and individuals.

The paper deliberately took some extreme positions in order to impress upon those potentially affected the importance of making submissions.

Upon the issuance of the paper, a Finance Department committee was set up to receive both oral and written submissions. The members of the Charities Study Committee varied but there was a core group of four, three of whom were always present at oral presentations and all of whom read the written submissions.

From a tactical point of view, the approach worked like a charm. The committee read over 200 briefs and attended presentations by 30 other groups. In some cases, the committee left Ottawa to see charities in action, which included attendance at a board meeting of a private foundation, touring facilities operated by charities and examining the workings of a business controlled by a charity.

The upshot of all this was threefold. First, the members of the committee got to hear first hand exactly what the technical problems of charities were. Second, they discovered that some charities, primarily private foundations, were in fact “abusing” the tax system. Third, they found that for many other charities, the tax system was a kind of straightjacket which interfered with their logical operations.

The committee reported back to the Minister, who by then was Donald Macdonald. Macdonald agreed to the committee’s recommendations and the tax changes were contained in his Budget of May, 1976.

The tax changes at that time fell into two broad categories. The bulk of the changes were “relieving” in nature, designed to give a more comprehensive tax framework for operating charities and to alleviate problems created by the tax laws. A few of the changes, however, were designed to toughen up the law, primarily as it related to private foundations, a category recognized in the Income Tax Act for the first time.

While no tax proposals get total approbation, responsible charities, including many private foundations, welcomed the changes as being both timely and fair.

The charity “exercise” has been held out as being one of the classic examples of a major tax reform within an area which was well thought out, well handled and well received. It was a model of consultation between government and taxpayers.

The Process: 1981

In the years between 1976 and 1981, there had been relatively few significant tax changes made affecting charities. The changes which were made (calculation of reserves, changes dealing with cultural property) were not onerous and, on the whole, reflected refinements of the 1976 changes, mostly of a technical nature.

It is true, however, that the attitude of the federal government towards charities seemed to change for the worse in this same period. For example, the government issued an ill-conceived Information Circular on political activity which it was forced to withdraw in the face of widespread criticism. The policies in that Circular were applied nonetheless. The government also proposed administrative changes which would have destroyed many of the schools in Canada which offered both religious and secular education. These proposals too were withdrawn after a public outcry.

But for those working closely in the charities area, the proposals, not the withdrawals, were the significant factors.

And those proposals were only the tip of the iceberg. Many charities and individuals in the past year or two have found themselves re-assessed on various matters. A few of these cases have ended up in court, with the taxpayers and Revenue Canada ending up about even in wins and losses.

The key thing, of course, is that there were signs that despite the utterances of politicians, charities seemed to become a greater target of the bureaucrats.

It is interesting to note that charitable donations are clearly identified as a tax expenditure in government documents. Indeed, this is the case even with gifts to the Crown, which is illogical in that the government ends up with 100% of the gift and issues a receipt worth substantially less than 100% to the donor.

In a popular magazine, a lawyer who subsequently was hired by the Tax Policy Branch of the Department of Finance identified charitable and medical expenses as examples of tax preferences which offer advantages to the rich. This tack has been followed in more academic journals, perhaps because charitable giving has been predominantly an activity of the well-to-do (for obvious reasons) and is easily identifiable in terms of both quantum and source.

In the pre-Budget period, there was a particular flurry of activity as charities and their representatives made submissions to the government, most of which were concerned with making charitable giving more attractive. What astonished unbiased observers was the naiveté of those submissions.

Anybody who had watched what was going on would recognize that the mood in Ottawa was negative towards charities and that the requests were unrealistic in terms of the economy, the mood and the prejudices of the advisers on tax matters in Ottawa.

It is interesting to note that by 1981, three of the four "core" people on the Charities Study Committee had left government service. The fourth had been isolated from charities work since the 1976 tax changes were announced. Thus, not only was the expertise built up by the Department of Finance mostly lost, what little was left was not utilized.

To a great extent, the decisions relating to charities were delivered into the hands of economists. This contrasted with the Charities Study Committee which consisted of three lawyers and an accountant.

The economists not only view charitable donations as tax expenditures but also do not distinguish between income, as it is generally accepted for tax purposes,

and capital gains. Once one remembers that in economic jargon “a buck is a buck”, the decision to treat a foundation’s capital gain as ordinary income, subject to the disbursement requirements, becomes understandable.

In a private conversation, one senior economist indicated that he had felt that the initial capitalization of one Canadian foundation should have been treated as income and that it was only a “loophole” which had allowed the foundation not to distribute its capital. While the Department stopped short of forcing past capital contributions to be paid out, it did propose changes which will require all accrued but unrealized past gains, as well as all future realized gains, to be paid out.

A word is in order about personnel. Probably the key element in the rational changes of 1975-76 was that the people involved were sympathetic to charities. The assistant deputy minister of the day had been in private law practice and had been intimately involved with charities. Thus, while he was familiar with the potential for abuse, he knew firsthand about the acceptable operation of most charities and the true charitable intent of most donors. He understood, for example, that one cannot ever be financially ahead of the game by giving money or property to charity. The tax donations only allow a person who is inclined to give to a charity to give more than might otherwise be the case.

There is no evidence whatever that there is any person in the tax-policymaking end of Finance who feels the same way or who has had direct experience with charities.

The November 1981 proposals were in marked contrast to those of the 1975-76 period. There was no discussion between government and charities about proposals. There was no warning about the trend of thinking nor was there any attempt to solicit the views of charities. Indeed, in the post-Budget period, meetings between charities and officials have been reported as being useless in that the officials have made up their minds and appear to be totally uninterested in discovering what the effect of the proposals is. It may well be, however, that according to their own views, if the effect is negative on charities, this is not necessarily bad.

It is important to note that the traditional claims of the need for Budget secrecy do not apply in the case of charities. In the case of individuals, many tax proposals need be hidden until unveiled to prevent a re-arrangement of affairs to take advantage of, or to avoid, the impact of changes. But as the earlier experience shows, dealing with charities through a Green Paper or similar process does not invite tax manipulation. Indeed, charities are, for the most part, so scrutinized by various governmental and private eyes that manipulation is well nigh impossible.

Mr. MacEachen promised that the changes relating to charities will be put before a Parliamentary Committee. As this is written, no steps whatever to set up such a committee have been taken. But observers are betting that reference to committee will result in many pious words and little substantive change.

The truth of the matter is that unless the charities can get broad public support behind any campaign against the changes, support which will translate into

political pressure, the mood in Ottawa is not encouraging. In the past, notably with the political activities question and to a lesser degree, the religious schools question, effective political action was taken. This time around, so many sectors of the public have been goaded by the Budget that few have the time or inclination to help fight other peoples' battles.

In summation, the changes proposed in the Budget are undoubtedly harsh and potentially disastrous to charities. The process was undemocratic, especially when viewed against the past experience. But the signs of bureaucratic hostility to charities have been around for several years for all to see. These changes were just a statutory culmination of the anti-charities mood rampant in the backrooms of Ottawa.