

# Recent Tax Developments

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## **Proposed Tax Reform Affects Individual Donors**

On June 18, 1987 the Hon. Michael Wilson, Minister of Finance, tabled his long-awaited Tax Reform Package in the House of Commons. For many years, a substantial segment of the charitable community has lobbied the government for tax credits for charitable donations instead of the tax exemption provided under the present system. The reformers have won out and the White Paper of Tax Reform proposes to introduce a credit against tax for charitable contributions in place of the present system where charitable contributions are deducted before tax is computed.

The proposal, which applies only to individual and not corporate taxpayers (who will retain their present deductions), is that the present deduction be converted to a two-tier credit of 17 per cent of annual contributions up to \$250 and 29 per cent for the portion of contributions over \$50. According to the White Paper, this will maintain a substantial incentive for charitable giving and at the same time increase fairness by basing tax assistance on the amount given, regardless of the income level of the donor.

As a general rule, the deduction system favours high-income taxpayers while a credit system favours lower-income taxpayers. This is because a donor whose marginal tax rate is 50 per cent saves, in effect, 50 per cent of every dollar given to charity while a taxpayer whose marginal tax rate is only 25 per cent saves only 25 per cent of each dollar given to charity. Under the present deduction system, a \$100 donation costs a taxpayer with a marginal rate of 50 per cent, \$50 and the taxpayer whose marginal rate is 25 per cent, \$75.

At first blush, the conversion of deductions into credits appears to be fair and to maintain the incentive for charitable giving. Because of the general lowering of tax rates proposed by the White Paper, however, it may be questionable whether the high-income taxpayer will have the same incentive to make charitable donations under the proposed system as at present. When the top marginal rate of tax was 60 per cent high-income taxpayers who gave one dollar to charity saved 60 cents in tax and therefore the donation only cost 40 cents. If the marginal rate of tax is reduced to 40 per cent, however, when a donor gives one dollar to charity, the tax saved will be approximately 40 cent and the donation will cost the donor 60 cents.

A strong argument can be made that as a general rule, “small donors” are not motivated by tax savings when they give to charity. Donors who give modest amounts give such amounts because they wish to do so and not because they will save tax. On the other hand, in the past, donors in high income-tax brackets have had a strong incentive to make donations to charities in order to save tax. In our experience, while donations may not be totally tax motivated, the tax savings have provided a strong incentive for many donors to make substantial donations. It will be unfortunate if, in the interest of fairness, the conversion of the present deduction for charitable contributions into credits provides less incentive for large donors to make charitable contributions.

Another concern evoked by the proposed reform is that it will be easy for the government to increase tax rates without increasing the rate of the credit once tax reform is in place. This would mean that the level of tax saving would be frozen, while the tax imposed could increase.

Some of these concerns were expressed in an editorial in the *Toronto Star* on Monday, June 22, 1987. In the article, the writer expresses doubt that the incentive to large donors will be maintained under the proposed system. In Toronto, a donor who gave the United Way \$1,500 last year says, not entirely in jest, that he'll give the equivalent amount—\$800—after tax reform. If everyone does that, the writer feels the new system spells financial doom for the voluntary agencies and asks, “Will they have to turn to the government to make up the shortfall? Is that what Wilson wants?” The editorial goes on to propose that a tax credit be provided at the rate of 40 per cent for donations up to \$500 and 50 per cent for donations above \$500. If this were done, the writer states, “Then everyone would have an incentive to give more and the charities could market their fund drives the way political parties do.”

In our view, the voluntary sector has had its crack at having the charitable deduction section of the *Income Tax Act* reformed. It has made strong representations to the Department of Finance over the years advocating credit systems. When the rates were 60 per cent, the advocates for reform proposed a credit of 50 per cent of donations made as a credit against tax payable. This would have provided an incentive to taxpayers to make charitable donations. When the top marginal rate of tax dropped to 50 per cent, such a credit would have had the same effect as the exemption for taxpayers in the high tax bracket. While the new credit system will maintain the status quo, the incentive originally proposed is not there. However, it seems, unless a strong opposition is mounted, the proposal will be enacted into law.