Thinking Critically About the Taxation of Capital Gains on Donated Public Securities (or Looking Paragraph 38(a.1) in the Mouth)

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KEYWORDS: CHARITIES ■ DONATIONS ■ CAPITAL GAINS ■ SECURITIES ■ TAX CREDITS ■ TAX EXPENDITURES

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INTRODUCTION

The federal government announced in its 1997 budget that it would halve the inclusion rate for capital gains realized on certain charitable donations of public securities.[1] At the same time, it issued a stern warning that "[a]fter five years, this

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1 The budget announcement was implemented by SC 1998, c. 19, section 6, which added paragraph 38(a.1) (applicable after February 18, 1997) to the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as "the Act"). Unless otherwise stated, statutory references in this article are to the Act. The inclusion rate reduction applies to gifts of shares, debt obligations, or rights listed on a prescribed stock exchange, as well as mutual fund and related segregated fund interests, to any registered charity or other qualified donee with the exception of private foundations.

provision will be terminated if it has not been effective in both increasing donations and distributing the additional donations fairly among charities."[2] These conditions seemed to imply that the government would need to see clear evidence of a positive impact before deciding to continue this incentive. In October 2001, when former Finance Minister Paul Martin announced the government's intention to make the provision permanent, the department's news release stated in part:

> From the data available, it appears that this measure has been an effective additional incentive for people to make donations to charities. . . . This is exactly what the measure was designed to do. . . .
>
> Data for the 1997-2000 period show that both the number and the value of donations of securities have significantly increased. They also show that a broad range of charitable areas—education, health, religion, welfare—have benefited from it. These results are consistent with those reported in a study commissioned by the charitable sector.[3]

While the news release did not provide further details, it may be presumed that the minister was relying on the same data reviewed by the Department of Finance in its report, released about one year later, entitled "Special Federal Tax Assistance for Charitable Donations of Publicly Traded Securities."[4] Unfortunately, however, that report provides no such clear evidence of any positive benefits flowing from paragraph 38(a.1), and no reassurance that this tax expenditure was evaluated with appropriate rigour before the government decided to retain it permanently. As the authors themselves acknowledge, the data reviewed in the report are far too limited and superficial to support the conclusion that paragraph 38(a.1) has met the government's preconditions for retention. In fact, read carefully, the report raises more questions than it answers.

In this brief comment, I argue that there is a heavy onus on the government to justify the continuation of this tax expenditure as an effective and equitable method of assisting the charitable sector, especially in light of its regressive effects on the distribution of the tax burden. I explain that the Department of Finance report does not provide an adequate basis for this important tax policy decision, because of severe limitations in its underlying data and because it lacks any qualitative analysis of the impact of paragraph 38(a.1). I suggest additional questions and data that would need to be probed in order to evaluate in a serious way the performance and fairness of this measure, and its full implications for the non-profit sector. More critical thinking is needed on this issue before the government proceeds with its plan to consider "whether there is an appropriate and cost-effective basis for

2 Canada, Department of Finance, 1997 Budget, Budget Plan, February 18, 1997, 114.

3 Canada, Department of Finance, "Special Federal Tax Assistance for Charitable Donations of Publicly Traded Securities Made Permanent," *Release* no. 2001-089, October 12, 2001.

4 "Special Federal Tax Assistance for Charitable Donations of Publicly Traded Securities," in Canada, Department of Finance, *Tax Expenditures and Evaluations 2002* (Ottawa: Department of Finance, 2002), 59-74 (herein referred to as "the report").

broadening this measure beyond its current application."[5] Before any such decisions are taken, paragraph 38(a.1) should be properly evaluated by an outside body, independent of both government and the charitable sector.

WHY THERE IS A HEAVY ONUS ON GOVERNMENT TO JUSTIFY RETAINING OR EXPANDING PARAGRAPH 38(a.1)

The notion that governments must rely more heavily on voluntary agencies to provide public services has become a truism of contemporary political discourse. Certainly it is the rationale offered by the federal government for dramatically enhancing the tax incentives for charitable giving over the last decade. The 1997 budget documents, for example, stated that "the government fully recognizes the increasingly important role the charitable sector is playing in meeting the needs of Canadians,"[6] and that "[s]ocial needs are met not merely through income support. They are also met through services delivered in the social economy."[7] Representatives of the charitable sector have rightly complained that direct government funding for non-profit agencies has dried up at the same time as the demand for the services delivered by such agencies has intensified. If enriched tax incentives are being offered as the public policy response to this problem, it is incumbent upon the government to ensure that these incentives are in fact delivering more support where it is needed. In addition, charitable tax credits significantly reduce government revenues and can be justified only if they are producing demonstrably positive effects on the quantity and quality of services available to those who need them.

There is significant controversy and debate about the fundamental merits of shifting social welfare functions from the state to the charitable sector.[8] However, regardless of one's position in that debate, there is a pressing need for careful evaluation of charitable tax incentives. Those who support a larger role for charities should insist on sound, evidence-based decision making as to what are the most effective policy instruments for helping charities to expand their activities successfully. There is a danger that the tax system will be overused in the rush to support and expand the work of the charitable sector, without a careful assessment of its effectiveness as a policy instrument, and without adequate attention to the costs and disadvantages of using tax incentives for donors as the primary means of boosting charitable activity (as opposed to, for example, increasing direct government funding

5 Ibid., at 69.

6 Supra note 2, at 111.

7 Ibid., at 102.

8 For a thorough discussion of the recent history of this debate and a strong critique of the arguments for offloading the delivery of public services to voluntary agencies, see Neil Brooks, "The Role of the Voluntary Sector in a Modern Welfare State," in Jim Phillips, Bruce Chapman, and David Stevens, eds., *Between State and Market: Essays on Charities Law and Policy in Canada* (Montreal and Kingston, ON: McGill-Queen's University Press for the Non-Profit Sector Research Initiative, 2001), 166-216.

of charities). Tax expenditures can be seductive as a kind of quick fix for a number of reasons, including the fact that they do not require outlays of new money by specific government departments (which are reluctant to accept additional demands on their budgetary allocations), and they can be administered through the existing infrastructure of the Canada Customs and Revenue Agency (CCRA). However, it is often too easily assumed that tax incentives actually change behaviour in desired ways. Advocates of an expanded role for charity have a strong interest in testing these assumptions to ensure that the tax provisions are in fact delivering the added resources that the sector so urgently needs at the present time.

For different reasons, critics of the shift from welfare state to charity will also be concerned about the lack of evidence that enhanced tax incentives are translating into needed public services. While recognizing the valuable contributions that charities can make to society, these critics have warned of several problems that are likely to arise if governments continue offloading more and more of their social service functions onto the charitable sector. By providing tax credits to donors, governments provide indirect support for the social programs delivered by charities, but the total cost and the distribution of this support among different programs or needy groups are far less transparent and accountable than when the state directly finances social welfare agencies or programs.[9] In addition, there are concerns about decentralizing service provision to organizations that are spread unevenly throughout the country, are not centrally coordinated, and are not necessarily accountable to those who require social services.[10] These critics have also observed that the charitable tax credit transfers decision-making power over what services are funded from elected governments to individual philanthropists, and especially to a small group of very wealthy donors.[11] Besides raising concerns about democratic control of public services, this system is likely to result in disparate levels of funding to different services depending, not on the needs of citizens, but on the preferences and wealth of those who make charitable gifts. For example, David Duff refers to studies that show that higher-income individuals tend to direct a higher proportion of their donations to hospitals, higher education, and arts and culture charities, while those with lower incomes are more likely to donate to religious organizations and social welfare agencies.[12] In addition, I have written elsewhere about the concern

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9 See Kimberley Scharf, Ben Cherniavsky, and Roy Hogg, *Tax Incentives for Charities in Canada*, CPRN Working Paper no. CPRN 03 (Ottawa: Canadian Policy Research Networks, 1997), 8.

10 See Michael H. Hall and Paul B. Reed, "Shifting the Burden: How Much Can Government Download to the Non-Profit Sector?" (1998) vol. 41, no. 1 *Canadian Public Administration* 1-20, at 4-6; Lester M. Salamon, *Partners in Public Service: Government-Nonprofit Relations in the Modern Welfare State* (Baltimore: Johns Hopkins University Press, 1995), 266; and Julian Wolpert, *Patterns of Generosity in America: Who's Holding the Safety Net?* (New York: Twentieth Century Fund Press, 1993), 17-19 and 24-26.

11 See Neil Brooks, "The Tax Credit for Charitable Contributions: Giving Credit Where None Is Due," in *Between State and Market*, supra note 8, 457-81.

12 David G. Duff, "Charitable Contributions and the Personal Income Tax: Evaluating the Canadian Credit," ibid., 407-56, at 416.

that non-profit agencies that are perceived as feminist or as serving only women are often compelled to rely on a less affluent, primarily female base of donors for financial support.[13]

The introduction of paragraph 38(a.1) and other recent reforms has been justified in part by the claim that Canada should match or exceed the generous tax incentives available to donors in the United States. In fact, a significant portion of the Department of Finance report is devoted to a comparison of Canadian and US tax support for charitable giving.[14] Yet this perspective ignores the possibility that Canadians may desire a different balance between state-provided public services and reliance upon charity to meet social and cultural needs. For critics who question the benefits of moving toward a more American model of philanthropy, it is imperative that the government monitor the impacts of all charitable tax incentives, including the reduced inclusion rate for gifts of public securities.

The onus on the government to demonstrate a public benefit from this new provision is especially heavy because the charitable tax incentives are so regressive in their immediate distributive effects. The value of charitable tax credits claimed rises steadily with income, and because of the two-tiered structure of section 118.1, those with higher incomes generally have their donations credited at a higher rate per dollar donated than those with lower incomes.[15] The credit is also gender biased in that it delivers tax savings disproportionately to men.[16] It seems likely that these regressive features are accentuated in the case of gifts of appreciated capital property since capital gains are received disproportionately by higher-income individuals. Recent enhancements to the credit have also stimulated new planning strategies that are likely to reduce the tax burden of very wealthy individuals.[17]

It should be noted that paragraph 38(a.1) is not needed to protect donors from having to pay capital gains tax when they give appreciated capital property to charity. The Act has long permitted a rollover for such gifts provided that the taxpayer does not claim more than the adjusted cost base of the property for purposes of the charitable tax credit.[18] More recently, for those donors who wish to obtain a credit for the full value of their property, income ceilings have been raised to ensure that any taxable capital gain realized on such a gift can be fully offset by the credit in the

13 Lisa Philipps, "Tax Law and Social Reproduction: The Gender of Fiscal Policy in an Age of Privatization," in Brenda Cossman and Judy Fudge, eds., *Privatization, Law, and the Challenge to Feminism* (Toronto: University of Toronto Press, 2002), 41-85, at 72-77.

14 Report, supra note 4, at 66-67.

15 Duff, supra note 12, at 418-20.

16 Philipps, supra note 13, at 80.

17 Some of these strategies are reviewed in Blake Bromley, "New Rules for Charitable Giving," in *Report of Proceedings of the Forty-Ninth Tax Conference*, 1997 Conference Report (Toronto: Canadian Tax Foundation, 1998), 27:1-11. The decision in *Jabs Construction Limited v. The Queen*, 99 DTC 729 (TCC) suggests that such planning will be difficult to challenge under the general anti-avoidance rule.

18 See subsection 118.1(6).

year in which the donation is made.[19] In the majority of cases, the credit will exceed the tax on any capital gain realized as a result of the gift, and the balance may be used to shelter other income from tax. The reduced inclusion rate in paragraph 38(a.1) will simply enhance this sheltering effect for donors who claim the full fair market value of the gifted property as a tax credit. Granting such a significant tax reduction to some of the wealthiest individuals in the country is usually justified on the basis that it will stimulate additional donations to charity. My point is that in light of the regressive effects of such measures on the distribution of the tax burden, such stimulative effects must be demonstrated rather than simply asserted.

Some tax commentators, as well as representatives of the charitable sector, have suggested or openly advocated further enrichments to charitable tax incentives. For example, David Stevens has argued that although the changes announced in recent budgets have generally been favourable for donors, they have been "very harsh with respect to private foundations."[20] The Canadian Centre for Philanthropy has lobbied the federal government to eliminate entirely capital gains tax on gifts of public securities and to extend paragraph 38(a.1) to private foundations.[21] In addition, the Alzheimer Society of Canada recently announced that the government is considering recommendations to eliminate capital gains tax on gifts of public securities and to extend the same capital gains preferences to donations of real property.[22]

The Department of Finance will no doubt consider the possible revenue impact of any such changes, including the potential risks of extending capital gains relief to donations of real estate or other forms of property for which objective market valuations are more difficult to obtain. As the government's experience with gifts of cultural property demonstrates, there would be a temptation for some donors to assign inflated values to their gifts in order to increase their tax credit, and a consequent need for extra resources to administer and enforce the limits of the credit.[23] In addition to studying revenue impacts, however, the government should carefully assess whether enhancing the credit will deliver adequate returns to justify the cost and the distributive inequities. The assumption underlying arguments in favour of more tax incentives is that they will benefit not only the affluent taxpayers who primarily claim them, but innumerable less-privileged Canadians who rely on the services of charitable organizations. However, assumptions are not an adequate basis for decision by tax policy makers. Detailed evidence of wide public

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19 This was achieved by amendments to subparagraph (a)(iii) of the definition of "total gifts" in subsection 118.1(1), introduced by SC 1997, c. 25, section 26, applicable to 1996 and following years, and SC 1998, c. 19, section 22(4), applicable to taxation years beginning after 1996.

20 David P. Stevens, "Update on Charity Taxation," in *Report of Proceedings of the Fifty-Third Tax Conference*, 2001 Conference Report (Toronto: Canadian Tax Foundation, 2002), 28:1-56, at 28:2.

21 Canadian Centre for Philanthropy, *Pre-Budget Submission to the House of Commons Standing Committee on Finance* (Toronto: Canadian Centre for Philanthropy, September 2002).

22 See "What's New?" on the Alzheimer Society of Canada Web site at http://www.alzheimer.ca (accessed February 22, 2003).

23 For an interesting discussion of these issues, see Duff, supra note 12, at 414-15.

benefit should be presented before the charitable tax incentives are expanded any further. As explained in the next section, the Department of Finance report does not deliver that evidence.

LIMITATIONS OF THE DEPARTMENT OF FINANCE REPORT

As discussed previously, the two conditions imposed by the 1997 budget for extending the reduced inclusion rate beyond the initial five-year trial period were (1) that it increase the quantum of donations and (2) that the additional donations be distributed fairly among charities. The report reviews donation data drawn from personal income tax returns for the 1997-2000 taxation years, and if read superficially, these data appear to suggest that paragraph 38(a.1) has met both of the government's conditions. However, the authors of the report wisely refrained from stating any such conclusion directly, since it is not in fact supported by the data. This section unpacks the meaning of each condition and explains why the information presented in the report does not provide a sufficient basis for determining that either has been met. To underline this critique, I suggest other kinds of information that could be reviewed to improve the quality of the analysis.

The Quantum of Charitable Donations: Why the Report Fails To Demonstrate That the Government's First Condition Has Been Satisfied

Notably, the report does not state anywhere that the halved inclusion rate has been successful in generating additional donations. In a carefully worded conclusion, the authors state only that "[a]vailable data indicate that there has indeed been significant growth in the value of gifts of publicly traded securities" over the four-year period studied in the report.[24] The value of donated public securities that was reported on personal tax returns nearly tripled during this period, rising from $69.1 million to $200.3 million, and the number of donors of such securities rose almost five times (from 500 to almost 2,400).[25] Further, gifts of public securities grew faster than total donations. For example, in 1999 total donations grew 4.1 percent, whereas gifts of publicly traded securities to public charities grew 62.9 percent.[26] While these figures look good on their face, the report does not analyze the extent to which donors may have simply substituted gifts of public securities for gifts of cash or other assets that they would have made in any event.

It seems obvious that the government's first condition calls for evidence of an increase in aggregate donations of all kinds to registered charities, as opposed to simply a change in the form of donations. However, the report does not highlight this distinction in meaning, nor does it discount the possibility that paragraph 38(a.1)

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24 Report, supra note 4, at 68.

25 Ibid., at 64.

26 Ibid.

may have caused a shift in the preferred form of donations but no increase in aggregate gifts to charity. In fact, the authors acknowledge toward the end of the report that "it is difficult to assess the extent to which individuals who would otherwise have made cash donations may have switched to donations of listed securities."[27] The report identifies several major limitations in the data relied upon, including the following:[28]

- the short time frame of the analysis (three years of estimates, plus projections for the year 2000);
- the buoyancy of the economy during this period and the possibility that this may be responsible for stimulating "more donations, and larger donations, than could be expected over an entire economic and market cycle";
- the complete lack of any comparative data on gifts of public securities in earlier years; and
- the fact that other charitable tax incentives were introduced in the same period, such as the raising of the annual ceiling on claimable gifts from 50 percent to 75 percent of net income, and the difficulty of isolating the effects of one incentive from another.

The problem of the short time frame could have been addressed easily by committing to ongoing evaluation in future years. The evidence gathered in the report is perhaps intriguing enough to justify extending the provision, say, for another five years, to allow further investigation of its effects over a more representative economic cycle that included the downturn in stock markets since 2001. By making the provision permanent now without any explicit undertaking to continue evaluating its effects, the government has virtually ensured that paragraph 38(a.1) will join the ranks of most tax expenditures, which are obscure to almost all members of the public and are virtually never scrutinized regarding their cost-effectiveness or fairness relative to other possible policy instruments.

The lack of historical statistics on gifts of public securities before 1997 is not as easy to overcome. However, it is not clear that such statistics would help very much to establish that paragraph 38(a.1) has stimulated an increase in donations. Assuming that it could be shown that donations of public securities were consistently lower before 1997 than after, there is still the problem of determining what accounts for this change in donors' behaviour, and whether it represents a net increase in charitable gifts or merely a substitution of listed shares for cash, private securities, or other assets that would have been donated in the absence of paragraph 38(a.1). What might be more revealing is to compare overall donation levels pre- and post-1997, and these data are certainly available. The report shows that total gifts to charity by individuals, as reported in income tax returns, rose by 10.1 percent, 4.1 percent, and 2.6 percent in 1998, 1999, and 2000, respectively. These figures initially seem

27 Ibid., at 69.

28 Ibid., at 63 and 69.

very impressive, but are less so when compared with earlier data, which show that donation levels have been rising at similar rates since at least 1985.

In a recent paper, David Sharpe reviewed statistics on total charitable gifts claimed in personal income tax returns from 1984 to 1997, a period exactly preceding that covered in the report, and found the following changes in the value of donations each year:[29]

Year	*% increase in value of gifts over previous year*
1985	9.1
1986	9.0
1987	12.3
1988	8.1
1989	9.3
1990	6.6
1991	3.8
1992	2.9
1993	2.6
1994	0.3
1995	4.0
1996	12.9
1997	7.7

These data indicate that donation growth has not been exceptional since the introduction of paragraph 38(a.1). The increases of 10.1 percent, 4.1 percent, and 2.6 percent for 1998, 1999, and 2000, respectively, are not strikingly different from those in earlier years and in fact are relatively low for the last two years, especially in light of the strong economic conditions that prevailed between 1998 and 2000. These facts cast serious doubt on the claim that paragraph 38(a.1) has generated a net increase in donations. Rather, they suggest that a large portion, if not all, of the rapid growth in donations of public securities since 1997 represents merely a shift in the form of donations rather than a trend toward donating more.

Another limitation identified in the report is the difficulty of isolating the effects of paragraph 38(a.1) from those of other charitable tax incentives introduced in the same period. Most important, the income ceiling that limits how much a taxpayer can claim in respect of the charitable donations tax credit in a particular year was raised from 20 percent to 50 percent of net income in 1996, and then to 75 percent of net income in 1997, the year in which paragraph 38(a.1) was introduced.[30] As a

29 David Sharpe, "The Canadian Charitable Sector: An Overview," in *Between State and Market*, supra note 8, 13-48, at 30, table 2.9.

30 See amended subparagraph (a)(iii) of the definition of "total gifts" in subsection 118.1(1), supra note 19. Note that these amendments also raised the ceiling by a proportion of any taxable capital gain realized on a donation of capital property (currently 25 percent), to ensure that the full amount of any such gain can be offset in the year of the gift by the charitable donations tax credit. Note further that the ceiling on charitable gifts was raised even higher, to 100 percent

consequence of this change, donors may have reported higher donation amounts in 1996 and the immediately following years, whereas previously the lower income ceiling would have required a large donation to be reported over a longer period of years. This may help to explain the sudden large jump in reported donations between 1996 and 1998, followed by significantly smaller increases in 1999 and 2000. The possible importance of higher income ceilings could be explored further by calculating the value of taxpayer donations relative to net income for the years around the change. While individual calculations would be most revealing, even an aggregate calculation may reveal a correlation between higher income ceilings and larger donations relative to income.

Another way to assess the impact of halving the inclusion rate for gifts of public securities would be to conduct qualitative surveys or focus-group sessions with donors and charities. The report notes that there is a relatively small number of individuals (about 2,400 in 2000) who donate such securities. No doubt a survey could be designed that would investigate those individuals' pre-1997 donation levels and the effects of paragraph 38(a.1) on their decision making about both the quantum and the form of their donations. As it stands, the report prepared by the Department of Finance provides no reliable evidence of any causal relationship between the halving of the inclusion rate and the rise in overall donation levels since 1997.

Fair Distribution of Donations: Why the Report Fails To Satisfy the Government's Second Condition

Again, the report declines to state outright that the government's second condition has been satisfied. It concludes that gifts of public securities made between 1997 and 2000 "benefited charities that are widely distributed in terms of size, sector and charitable designation,"[31] but with the significant caveat that a disproportionate amount of such gifts was received by larger charities, educational charities, and public foundations.

The report makes no attempt to define what would constitute a "fair" distribution of these donations, implying only that they should be distributed in some fashion among a few major categories and types of registered charities. Even by this minimum standard of fairness, the provision does not fare well. The distributive biases noted in the report toward certain types of charities are in fact quite extreme. For example, while educational charities received only 15.8 percent of total reported gifts in 1997, they received 42.2 percent of the value of donations of public securities, which is far more than any of the other categories of charity reviewed in the report. (The closest was welfare charities, at 30.5 percent, followed by religious charities, at 11.9 percent.)[32] Likewise, large charities received 36 percent

of net income for the last two years of a taxpayer's life: see subparagraph (a)(ii) of the definition of "total gifts" in subsection 118.1(1), as amended by SC 1997, supra note 19.

31 Report, supra note 4, at 68-69.

32 Ibid., at 65.

of total gifts by comparison with smaller charities, but 56.4 percent of gifts of public securities.[33] As between charitable organizations and public foundations, the latter received only 15 percent of total gifts, but 60 percent of the value of public securities donated in 1997.[34]

Here again, the report raises more questions than it answers. First, the data would be more revealing if massive categories such as "education" or "benefits to the community" were broken down to show the different types of activities encompassed by each and the distribution of donations among more specific types of charities. As discussed by Sharpe, the CCRA does provide some breakdown of the general categories into a finer typology.[35] Its classification scheme reveals, for example, that "education" charities include both teaching institutions and organizations that promote arts and culture, and that "benefits to the community" encompasses a diverse array of groups such as libraries and museums, as well as recreation, playgrounds, and camps.[36] It is also regrettable that Finance chose not to examine, or to disclose, the distribution of public securities donations among different provinces or regions. Surely a relatively even distribution of such gifts across the country should be one factor in evaluating the fairness of paragraph 38(a.1).

The report makes no attempt to probe the reasons for or implications of the strong tendency of donors to give public securities to certain types of charities. In the education sector, are large blocks of shares being donated to universities because these institutions offer naming rights to buildings or classrooms, or because they offer some visibility to donors who wish to recruit employees from the student body? Which types of educational programs are being funded through such donations, and which are being passed over? These questions speak to a larger criticism, that the report provides almost no qualitative analysis of the kinds of charitable activities that have been facilitated by gifts of public securities, or those that have been neglected. This would require detailed study of how donations are being used by the charities that receive them and whether an adequately broad range of services is being supported. Similarly, why are donors making these gifts so disproportionately to charities that are large and/or public foundations? Do these charities have more sophisticated financial management systems for handling donations of listed securities? How might this donating trend centralize or otherwise alter decision making about what services receive funding?

THE NEED FOR INDEPENDENT ANALYSIS OF PARAGRAPH 38(a.1)

Former Finance Minister Paul Martin deserves credit for insisting on a five-year trial period for this new incentive and an evaluation based on specific criteria. This

33 Ibid.

34 Ibid., at 66.

35 Supra note 29, at 14.

36 Ibid., at 16-17.

approach is consistent with one of the most important insights of tax expenditure theory, that policy makers should actively evaluate the effectiveness of tax subsidies to achieve clearly articulated program objectives, rather than simply assume that tax incentives change behaviour in desirable ways. The publication by the Department of Finance of its report also provides a degree of transparency about the costs of this measure and goes some way toward addressing the objection that tax expenditures are hidden subsidy programs. It is disappointing, then, that the minister and his department did not follow through with a more rigorous and fine-grained study of paragraph 38(a.1).

Department of Finance staff undoubtedly possess the expertise to conduct a more sophisticated study. However, they are not sufficiently independent from the government or the minister of finance, or from the political pressures and aspirations that inform ministerial decision making, to conduct the kind of disinterested critical analysis that is called for in this case. Their report demonstrates, beyond a shadow of a doubt, the political constraints on their work.

It cannot be ignored that decisions about the future of paragraph 38(a.1) are being made within an overall context in which there is tremendous political pressure to reduce personal income taxes in general, and capital gains taxes in particular. Since 1997, these pressures have led to significant general and targeted tax cuts. In this political climate, there is an obvious risk that paragraph 38(a.1) will be retained and perhaps expanded, whether or not it is actually contributing to a net increase in donations, because it provides an avenue for tax reduction to Canada's wealthiest citizens. While the prospect of reducing taxes for this group may be generally unpopular with the vast majority of Canadians, such an initiative may be rendered politically saleable if it is packaged as a way to finance charitable activities that benefit less-privileged citizens. This is not to suggest that the Department of Finance or those who lobby it are engaged in a nefarious plot to deceive the public about the real purposes of paragraph 38(a.1). However, it does seem clear that the department is under pressure from certain powerful constituencies to retain and expand charitable tax incentives, and that these constituencies are motivated by a mixture of altruism and self-interest. Given the array of political interests at stake, this program should be justified on the basis of a fully independent evaluation by experts outside the Department of Finance.

The charitable sector itself cannot be asked to review dispassionately the performance of a provision that it has so strongly advocated. Such advocacy is entirely legitimate in view of the increasing responsibilities being given to charitable organizations in Canadian society and the accompanying pressure on their resources. However, the charities must be seen as an interested party in this debate, lacking objectivity about the possible weaknesses of their own proposal and already entirely convinced of its merits. Certainly if the Department of Finance is relying even in part on a study conducted or commissioned by the charitable sector to confirm the benefits of paragraph 38(a.1), as both its October 2001 press release and its October 2002 report seem to suggest, the nature of that study and its results should be fully disclosed to the public.