Policy Forum: Comments on the Department of Finance's "Special Federal Tax Assistance for Charitable Donations of Publicly Traded Securities"

Editor's note: Many of Canada's public institutions that have operated as public charities—such as universities, hospitals, and cultural organizations—suffered from government spending cutbacks in the 1990s. Private charitable donations did not increase to make up the shortfall. To encourage more private donations, the federal government announced in its 1997 budget that if taxpayers made donations of publicly traded securities to such institutions, they would receive a charitable tax credit for the full fair market value of the gift and would have to include in their income only half of any taxable capital gain accrued on the shares.

Although this measure was not as generous as the tax treatment of charitable contributions of appreciated property in the United States, and it had been lobbied for by influential members of the charitable sector for many years, the government apparently enacted the change reluctantly. Some tax policy analysts expressed concerns about the cost-effectiveness of the measure and the fact that it would allow high-income taxpayers to exercise even greater control over the allocation of government largesse to their preferred charitable institutions. Therefore, the government enacted the measure subject to a sunset clause. The budget stated that "[a]fter five years, this provision will be terminated if it has not been effective in both increasing donations and distributing the additional donations fairly among charities."

Near the end of the year in which the measure might have expired, the Department of Finance announced that its objectives had been achieved. In a press release issued in October 2001, the department said that the measure had resulted in increased donations to a broad range of charities and therefore would be made permanent. One year later, in October 2002, the department included a study with its annual tax expenditure report entitled "Special Federal Tax Assistance for Charitable Donations of Publicly Traded Securities." Based on an analysis of the donations of publicly traded securities claimed on income tax returns from 1997 to 2000, the study purports to justify the government's decision to make this tax expenditure a permanent feature of the government's infrastructure for the funding of charities. In the conclusion of the study, the government stated that it would continue "to work with the charitable sector to determine whether there is an appropriate and cost-effective basis for broadening the measure beyond its current application." Particularly in light of the possibility that this measure will be considerably broadened, it seems appropriate to assess the bases of the study's conclusions. The three articles that follow offer differing views on both the study and the rationale for the measure.

William Innes argues that the department's study demonstrates that the measure has been successful; indeed, in his view, it has been so successful that it should be extended to provide a full exemption from tax for all capital gains accrued on publicly traded securities donated to public charities. As evidence that the rule has increased donations to public charities, he notes that the study finds that gifts of publicly traded securities increased by 190 percent between 1997 and 2000, while donations generally increased by only 18 percent. Innes argues that it is appropriate that educational, welfare, and health organizations have been recipients of most of the gifts of publicly traded securities, since they are the organizations that have been hardest hit by government cutbacks. He also argues that if Canadian universities and medical research institutions are to be competitive with equivalent US institutions, the tax treatment of gifts to public charities in Canada must be similar to that in the United States.

The Department of Finance study suggests that, on the one hand, if the measure did not cause any additional gifts of appreciated property to be made to public charities, its cost to the federal government was $40 million over the four-year period studied. On the other hand, if all gifts made were induced by the measure, its cost over this period was $181 million. The actual cost lies somewhere between these two numbers, depending upon how effective the measure was in inducing additional gifts. Innes argues that in fact the cost of the measure was probably much less than that suggested by this analysis. The analysis assumes that taxpayers would otherwise have immediately sold the appreciated property instead of donating it to a public charity. Innes argues that it is likely that most gifts of appreciated property are made with securities that taxpayers are holding as long-term investments. Consequently, if these taxpayers had not donated the property to a public charity, they would likely have held it for many years, perhaps even rolling it over on their death to their spouse. Thus, the real cost of the measure is not the tax that would have been paid if the securities had been sold in the year of donation but only the present value of the tax that would have been paid many years in the future. In many cases, this would be a trivial amount.

Lisa Philipps suggests that there is a heavy onus on the government to justify retaining or expanding this tax measure. Even though favourable tax treatment for charitable donations is normally justified on the ground of promoting pluralism, she says that this measure allows a small number of wealthy (male) individuals to determine which public charities will benefit from the government incentive. Moreover, the government spending implicit in the measure, like that in all tax expenditures, is less transparent, and the government is less accountable for it, than is the case for direct spending programs. Philipps argues that the results reported in the study do not satisfy the burden on the government to justify continuation of the measure. Although the value of donated public securities during the period covered by the study grew much faster than total donations, this could be due to a number of factors other than the incentive effect of the measure, such as the donors' substitution of gifts of public securities for gifts of cash, the dramatic increase in value of securities, and the introduction of other tax changes that might have affected giving over this period, such as the increase in the annual ceiling for claimable gifts. Philipps concludes that the study "provides no reliable evidence of any causal relationship between the halving of the inclusion rate and the rise in overall donation levels since 1997."

Philipps also takes strong exception to the study's conclusion that gifts of public securities between 1997 and 2000 "benefited charities that are widely distributed in terms of size, sector and charitable designation." Educational and large charities received a hugely disproportionate amount of such gifts, and the government did not even disclose how such gifts were distributed among provinces or regions. Philipps concludes by noting that in view of the obvious political pressure on the government from "certain powerful constituencies" to retain the measure, the government should commission an independent evaluation of it by experts outside the Department of Finance.

David Duff is also critical of the study and its conclusions. He reviews each of the most persuasive arguments for the special tax treatment of charitable contributions and concludes that, even if these arguments are accepted, they do not justify the exemption from tax of capital gains accrued on appreciated property contributed to public charities. Moreover, Duff argues that the measure can be questioned on the grounds (among others) that "instead of promoting a genuine pluralism . . . [it is] apt to foster a kind of 'philanthropic paternalism' where the mix of goods and services provided by the charitable sector is shaped more by an affluent minority than by the community as a whole." He disputes each of the claims in the study: "first, that the measure has proven to be 'effective' in increasing donations; second, that these increased donations have been distributed 'fairly' among charities; and third, that the additional incentive . . . is 'roughly similar' to that in the United States." On this last point, he also notes that "it is not clear why Canadian tax policy should follow the much-criticized US approach" and that if the Canadian government wishes to encourage the same number of large donations of financial capital as are made in the United States, it ought to consider restoring "taxes on the transfer of wealth."