Correspondence

To the Editor:
Addressing concerns raised by Lisa Philipps and David G. Duff regarding special federal tax assistance for charitable donations of publicly traded securities

In issue no. 2, 2003 of the Canadian Tax Journal, Lisa Philipps, of Osgoode Hall Law School, York University, and David G. Duff, of the Faculty of Law, University of Toronto, raised several concerns about the special federal tax assistance for charitable donations of publicly traded securities. The purpose of this letter is to address their concerns and outline the compelling case for the federal government to eliminate the remaining capital gains tax on gifts of listed securities in the upcoming budget.

The following outlines the major concerns expressed by Lisa Philipps and David Duff and my response to each.

Concern
The measure should be properly evaluated by an outside body, independent of both government and the charitable sector.

Response
The officials in the Department of Finance have conducted a professional and thorough analysis of the data since 1997. Their analysis, combined with the Deloitte & Touche survey of charities across Canada, confirmed the appropriateness of the government’s decision to make the measure permanent in October 2001. The Deloitte & Touche survey was conducted on behalf of the Council for Business and the Arts in Canada, The Canadian Association of Gift Planners, the National Society of Fundraising Executives, and the Association for Healthcare Philanthropy. The criterion for extension—that is, making the measure permanent—is the same as the criterion for enhancement—that is, complete elimination of the capital gains tax. Consequently, the analysis has already been done to confirm the appropriateness of implementing a full capital gains tax exemption for gifts of listed securities.


Concern

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. 3

Response

Higher-income individuals tend to allocate their charitable giving in a similar fashion to the government’s expenditures for the not-for-profit sector. For example, health care and education are the two largest expenditure categories for the government, and these areas generally receive the largest donations. They are also the government’s top two priorities. This issue should not be a concern.

Concern

Canadians may desire a different balance between state-provided public services and reliance upon charities to meet social and cultural needs. 4

Response

In order for Canada to attract investment and create jobs, we must have a corporate and personal income tax regime that is reasonably competitive with that of the United States. In order for Canada to attract the best and brightest professors, students, scientists, and researchers, our compensation levels must also be reasonably competitive with those in the United States. Income from endowment funds of US universities and hospitals provides crucial compensation and research support for faculty, medical professionals, and scientists, as well as scholarships and bursaries for talented, needy students. Our not-for-profit organizations also desperately need larger endowment funds, which are financed by private sector donors.

Concern

[T]he 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. 5

Response

Undoubtedly, a portion of the gifts of stock since 1997 was made by individuals who would otherwise have made cash donations. While it is impossible to quantify the percentage of substitution, anecdotal evidence indicates that it is a small percentage. There are numerous examples of individuals who, since 1997, have donated shares worth more than 10 times their aggregate charitable cash donations before 1997.

3 Philipps, supra note 1, at 916.
4 Ibid., at 917.
5 Ibid., at 919.
Charitable donations including pledges of shares of $5 million or more since 1997 total approximately $1 billion. These donors would not have considered selling their shares and donating the after-tax cash proceeds to charities if the capital gains tax had not been cut in half for these gifts in the 1997 budget.

Concern

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). . . .

These facts . . . 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.6

Response

There is absolutely no doubt that the prime reason for the dramatic increase in charitable gifts of listed securities since 1997 was the change in the Income Tax Act in that year’s budget. This fact can be confirmed by direct consultation with Canadian charities such as universities, hospitals, arts organizations, and the United Way/Centraide. For example, from 1956 to 1996, the aggregate quantum of gifts of listed securities to the United Way of Greater Toronto (which serves one in three Torontonians) totalled only $40,000. From 1997 to 2003, the agency has received donations of shares of over $20 million! The United Way and its donors can certainly confirm that the reason for the dramatic change in donor behaviour is the 1997 budget measure.

Concern

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 charities reviewed in the report. (The closest was welfare charities, at 30.5 percent, followed by religious charities at 11.9 percent). . . .

Why are donors making these gifts so disproportionately to charities that are large and/or public foundations?7

Response

Education and social services support for the needy in our society are two of the top priorities, along with health care. The disproportionate share of donations going to educational institutions and social service agencies such as Community Foundations should not be a concern. It should be welcomed.

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6 Ibid., at 920-21.

7 Ibid., at 922-23.
Concern

[T]ax recognition for charitable contributions should ideally take the form of a refundable credit with a declining rate structure based on the amount claimed, thereby providing a larger subsidy for small and medium-sized donations and a smaller subsidy for large donations.8

Response

For the government to treat large donations less generously than small donations would be counterproductive to the objectives of charities. Their goal is logically to maximize the amount of private sector donations so that they can deliver improved services to the millions of Canadians who benefit from their support.

Concern

[T]he mix of goods and services provided by the charitable sector is shaped more by an affluent minority than by the community as a whole.9

Response

Donors who contribute their hard-earned wealth in the form of listed securities give their wealth to well-managed, reputable not-for-profit organizations that are leaders in their field in Canada and internationally. Experience has shown that they give their wealth on a more responsible basis than has been the experience for many direct government-funded programs.

Concern

Nor does [the study] attempt to weigh the resulting increase in charitable contributions against the estimated cost of the measure, which the Department of Finance estimates at $15 million to $73 million in terms of forgone federal tax revenues in 2000, depending on whether equivalent donations would have been made in the absence of the measure.10

Response

The actual cost of the measure in the form of forgone capital gains tax is the discounted present value of the forgone tax, not the capital gains tax that is forgone today as a result of the gift. The donor’s alternative is simply to hold on to his or her shares and benefit from their appreciation over the years. In many cases, the discounted present value of the ultimate forgone capital gains tax is a tiny fraction of the value of the gift.

8 Duff, supra note 1, at 932.
9 Ibid., at 933.
10 Ibid., at 934.
If the capital gains tax were eliminated for gifts of listed securities and there was no increase in giving, the cost to the federal government would be $15 million in additional forgone capital gains tax. If donations doubled to $400 million from the $200 million level in 2000, the incremental forgone capital gains tax would be $30 million. (The cost of the charitable donation tax credit would be the same as for gifts of cash donations for the same amount.) The incremental costs in the form of forgone capital gains tax are minuscule compared with the incremental benefits of huge increases in charitable donations.

Concern

It is not clear why Canadian tax policy should follow the much-criticized US approach. On the contrary, while competitiveness concerns may drive other aspects of Canadian tax policy, differences between Canadian and US tax treatment of charitable contributions of publicly traded shares are unlikely to affect cross-border donations of these kinds of gifts.11

Response

We are competing with the United States for the best and the brightest faculty, researchers, medical professionals, scientists, and students. Funding for compensation, research, and student support is crucial to our ability to compete with the United States for this talent. Private sector funding through endowment funds, charitable foundations, and direct financial support is crucial to our ability to compete. For our charities to raise capital from the private sector to build endowment funds and fund operating expenses, we need to level the playing field with the United States for private sector fundraising by eliminating the remaining capital gains tax on gifts of listed securities.

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February 2004

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11 Ibid., at 936.

* Not-for-profit sector roles:

- Health care/research: Director, Toronto General & Western Hospital Foundation
- Education: Member, Advisory Board, Richard Ivey School of Business
- Social services: Member, 2003 Major Individual Giving Cabinet, United Way of Greater Toronto
- Trustee, Toronto Foundation for Student Success
- Arts: Director (Past Chair), Council for Business and the Arts in Canada
- Member, Campaign Cabinet, Canadian Opera House Fundraising Campaign