

# Tax Treatment of Charitable Contributions in Canada: Theory, Practice, and Reform

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## I. Introduction

In Canada, tax recognition for contributions to charitable organizations takes four separate forms. First, where a charitable contribution is made for the purpose of gaining or producing income from a business, Canadian courts have held that the amount of the donation is deductible under general rules governing the computation of the donor's net income from the business.<sup>1</sup> Second, where a corporation makes a qualifying gift to an eligible recipient, the corporation may deduct the fair market value of the gift in computing its taxable income either in the year of the gift or in any one of the five subsequent taxation years, subject to a limit expressed as a percentage of the corporation's income for the year.<sup>2</sup> Third, where an individual makes a qualifying gift to an eligible recipient, the individual may claim a non-refundable credit against basic income tax otherwise payable, the amount of which is computed as a percentage of the aggregate fair market value of all such gifts made during the year or in any of the preceding five years, also subject

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<sup>1</sup> See *Olympia Floor & Wall Tile (Quebec) Ltd. v. MNR*, [1970] CTC 99, 70 DTC 6085 (Exch. Ct.); and *Impenco Ltd. / Impenco Ltée v. MNR*, [1988] 1 CTC 2339, 88 DTC 1242 (T.C.C.).

to a limit expressed as a percentage of the individual's income for the year.<sup>3</sup> Finally, where property donated to an eligible recipient is qualifying cultural property, publicly-traded securities, or ecologically sensitive land, special rules reduce or eliminate the capital gains tax that would otherwise be payable if this property had appreciated in value prior to the making of the gift.<sup>4</sup> As a result, the Canadian income tax recognizes contributions to charitable organizations through a deduction in some circumstances, a non-refundable credit in others, and a full or partial exemption from capital gains tax otherwise payable on gifts of certain kinds of appreciated property.

This paper discusses the tax treatment of charitable contributions in Canada, evaluating each of these approaches by reference to what I contend to be the most persuasive rationale for tax recognition, and recommending specific reforms to the current statutory scheme. Part II considers different rationales and approaches for the tax recognition of charitable contributions, concluding that such recognition is

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<sup>2</sup> *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.) [hereafter ITA], section 110.1. As a general rule, the annual ceiling on deductible gifts is three-quarters of the corporation's income for the year. This limit is increased where the corporation is subject to capital gains or recaptured depreciation on donations of capital property, and does not apply to gifts of cultural property, ecological gifts or gifts to the Crown.

<sup>3</sup> The federal credit, on which provincial credits are based, appears in ITA, section 118.1. As with the deduction for corporate donations, the limit on the aggregate fair market value of gifts that may be claimed in a taxation year is generally three-quarters of the individual's income for the year, but is increased where the individual is subject to capital gains or recaptured depreciation on donations of capital property, and does not apply to gifts of cultural property, ecological gifts or gifts to the Crown.

<sup>4</sup> See ITA, subparagraph 39(1)(a)(i.1) (which exempts any capital gain on gifts of property that the Canadian Cultural Property Export Review Board has determined meets the criteria set out in paragraphs 29(3)(b) and (c) of the *Cultural Property Export and Import Act*, provided that the donation is made to an institution or public authority designated under subsection 32(2) of that Act), paragraph 38(a.1) (which reduces the inclusion rate on gifts of publicly traded securities from one-half to one-quarter), and paragraph 38(a.2) (which reduces the inclusion rate on gifts of ecologically sensitive land from one-half to one-quarter).

best justified as a way of subsidizing both the quasi-public goods and services provided by charitable organizations and the social and cultural pluralism that these organizations advance. Part III reviews statutory rules and judicial decisions governing the tax treatment of charitable contributions in Canada, examining eligible recipients, qualifying gifts, and different methods of tax recognition. Part IV concludes by recommending specific reforms to the current statutory scheme in light of the theoretical approach advanced in Part II.

## **II. Theory**

Tax recognition for charitable contributions is generally favoured on one of three grounds: to obtain an accurate measure of the donor's taxable income, to reward the donor's generosity, or to provide an indirect subsidy to eligible recipients by encouraging charitable donations. The following discussion evaluates each of these rationales and their implications for the manner in which charitable contributions should be recognized for tax purposes.<sup>5</sup>

### **A. Measuring Taxable Income**

The accurate measurement of taxable income is a question of horizontal equity, a basic principle of tax fairness according to which taxpayers who are similarly situated should pay similar amounts in tax. While the concept of horizontal equity affirms a principle of formal equality, the conclusion that two or

more taxpayers either are or are not “similarly situated” for the purpose of an income tax depends on a substantive conception of the ideal tax base. Since the definition of this base involves inclusions and deductions, moreover, the characterization of an accurate measurement of taxable income turns on the specification of appropriate inclusions and deductions.

As a general rule, those favouring the taxation of income (as opposed to personal consumption) have favoured an expansive concept of appropriate inclusions in order to ensure that the income tax applies to a broad measure of each taxpayer’s ability to pay.<sup>6</sup> According to Robert Haig, for example, the definition of taxable income should include “the money value of the net accretion to one’s economic power between two points of time.”<sup>7</sup> Similarly, suggesting that income “connotes, broadly, the exercise of control over the use of society’s scarce resources”, Henry Simons proposed that taxable income should include “(1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and end of the period in question.”<sup>8</sup>

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<sup>5</sup> Parts of this discussion are based on David G. Duff, “Charitable Contributions and the Personal Income Tax: Evaluating the Canadian Credit” in Jim Phillips, Bruce Chapman, and David Stevens, eds., *Between State and Market: Essays on Charities Law and Policy in Canada*, (Montreal and Kingston: McGill-Queen’s University Press, 2001) 407 at 426-36.

<sup>6</sup> See, e.g., Robert Murray Haig, “The Concept of Income – Economic and Legal Aspects”, in R.M. Haig, ed., *The Federal Income Tax*, (New York: Columbia University Press, 1920) 27; and Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy*, (Chicago: University of Chicago Press, 1938); Richard A. Musgrave, “In Defense of an Income Concept” (1967), 81 *Harv. L. Rev.* 44; and Victor Thuronyi, “The Concept of Income” (1990) 46 *Tax L. Rev.* 45. For a more critical view, see Boris I. Bittker, “A ‘Comprehensive Tax Base’ as a Goal of Income Tax Reform” (1967), 80 *Harv. L. Rev.* 925.

<sup>7</sup> Haig, “The Concept of Income” *supra* note 6 at 59.

<sup>8</sup> Simons, *Personal Income Taxation*, *supra* note 6 at 49-50.

With respect to appropriate deductions, theoretical approaches differ.<sup>9</sup> Although most conceptions of horizontal equity accept the legitimacy of deductions for reasonable expenses that taxpayers must incur for the purpose of producing taxable income,<sup>10</sup> opinion is divided on the extent to which personal expenses should be deductible in computing taxable income. While many tax theorists favour the deduction of non-discretionary expenses as necessary adjustments to measure each taxpayer's ability to pay,<sup>11</sup> others reject the deduction of all personal expenses on the grounds that they are discretionary or otherwise irrelevant to the appropriate definition of taxable income,<sup>12</sup> or inferior to other policy instruments as a way of subsidizing these expenses.<sup>13</sup> Adopting an altogether different approach, William Andrews has relied on Henry Simons' definition of personal income as the sum of personal consumption and savings to advance an alternative

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<sup>9</sup> For an excellent discussion of different approaches, see Tim Edgar, "the Concept of Taxable Consumption and the Deductibility of Expenses under an Ideal Personal Income Tax Base" in Richard Krever, ed., *Tax Conversations: A Guide to the Key Issues in the Tax Reform Debate*, (London: Kluwer Law International, 1997) 293-363.

<sup>10</sup> See, e.g., Richard Goode, *The Individual Income Tax*, Revised Edition (Washington, D.C.: The Brookings Institution, 1976) at 75; and Wayne R. Thirsk, "Giving Credit Where Credit is Due: The Choice Between Credits and Deductions Under the Individual Income Tax in Canada" (1980), 28 *Can. Tax J.* 32 at 33.

<sup>11</sup> See, e.g., Pierre Cloutier and Bernard Fortin, "Converting Exemptions and Deductions into Credits: An Economic Assessment" in Jack Mintz and John Whalley, eds., *The Economic Impacts of Tax Reform*, (Toronto: Canadian Tax Foundation, 1989) 45 at 54-62; and Robin W. Boadway and Harry M. Kitchen, *Canadian Tax Policy*, 3<sup>rd</sup> edn. (Toronto: Canadian Tax Foundation, 1999) at 131.

<sup>12</sup> See, e.g., Neil Brooks, "Comments on the Paper by Robin W. Boadway and Harry M. Kitchen" (1999), 47 *Can. Tax J.* 608 at 621: "One of the most fundamental principles underlying a fair tax system is that business expenses are deductible and personal expenses are not." See also Neil Brooks, "The Irrelevance of Conjugal Relationships in Assessing Tax Liability" in John G. Head and Richard Krever, *Tax Units and the Rate Scale*, (Melbourne: Australian Tax Research Foundation, 1996) 35.

<sup>13</sup> See, e.g., National Council on Welfare, *The Hidden Welfare System*, (Ottawa: National Council on Welfare, 1976) (regarding these deductions as "upside-down" subsidies worth more to high-income taxpayers than low-income taxpayers). Implicit in this critique, though generally not acknowledged, is an assumption about the appropriate tax base, by reference to which deductions for personal expenses are characterized as subsidies.

conception of taxable income according to which deductions would be allowed for all expenditures not amounting to personal consumption or saving.<sup>14</sup>

Elsewhere, I have questioned Andrews' concept of taxable income,<sup>15</sup> and favoured a concept of horizontal equity according to which deductions are properly allowed for non-discretionary expenses.<sup>16</sup> Although Andrews' approach might be appropriate for a tax on personal consumption,<sup>17</sup> it contradicts what I regard as the key purpose of an income tax: to impose a social claim on a share of each taxpayer's annual gains from participation in the market economy.<sup>18</sup> Further, while the latter approach is consistent with the denial of any deduction for personal expenses, it is my view that attention to differences in taxpayers' personal circumstances favours deductions for non-discretionary expenses such as the cost of basic subsistence, family obligations, or necessary medical care.<sup>19</sup>

From this perspective on the appropriate tax base, one can evaluate alternative arguments that tax recognition for charitable contributions is necessary to obtain an accurate measure of the donor's taxable income. Although this rationale for tax recognition implies that such recognition should take the form of a

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<sup>14</sup> William D. Andrews, "Personal Deductions in an Ideal Income Tax" (1972), 86 *Harv. L. Rev.* 309.

<sup>15</sup> Duff, "Charitable Contributions and the Personal Income Tax" *supra* note 5 at 427-28.

<sup>16</sup> See David G. Duff, "Disability and the Income Tax" (2000), 45 *McGill L. J.* 797; and David G. Duff, "Tax Policy and the Family: A North American Comparison" in *Proceedings of the Fifteenth Annual Conference of the Foundation for Fiscal Studies*, (Dublin: Foundation for Fiscal Studies, 2000) 36.

<sup>17</sup> See, *e.g.*, William D. Andrews, "A Consumption-Type or Cash Flow Personal Income Tax" (1974), 87 *Harv. L. Rev.* 1113.

<sup>18</sup> For an excellent statement of this conception, see Alvin Warren, "Would a Consumption Tax Be Fairer Than an Income Tax?" (1980), 89 *Yale L.J.* 1081. See also Charles R. O'Kelley, "Rawls, Justice, and the Income Tax" (1981), 16 *Geo. L. Rev.* 1.

deduction, the concept of taxable income advanced in the previous paragraph rejects Andrews' view that charitable gifts which do not enter into the donor's personal consumption ought to be deductible in computing the donor's income.<sup>20</sup> On the contrary, to the extent that the donor is legally entitled to the income from which the charitable contribution is made, the concept of income as the taxpayer's share of social output suggests that the amount of the donation should be included in computing the donor's income.<sup>21</sup> Similarly, while the concept of income proposed in the previous paragraph would permit a deduction for non-discretionary personal expenses, it is difficult to regard charitable contributions as non-discretionary in the same way as costs of basic subsistence, family obligations, or necessary medical care. Instead, notwithstanding Boris Bittker's argument that "charitable contributions represent a claim of such a high priority" that they should be excluded "in determining the amount of income at the voluntary disposal of the taxpayer in question,"<sup>22</sup> charitable gifts are best characterized as a discretionary form of personal expenditure not unlike other consumption expenses which are not

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<sup>19</sup> See Duff, "Disability and the Income Tax" *supra* note 16; and Duff, "Tax Policy and the Family" *supra* note 16.

<sup>20</sup> Andrews, "Personal Deductions in an Ideal Income Tax" *supra* note 14 at 317-31.

<sup>21</sup> For similar responses to Andrew's view, see Stanley S. Surrey, *Pathways to Tax Reform: The Concept of Tax Expenditures*, (Cambridge, Mass.: Harvard University Press, 1973) at 20-21; and Rick Krever, "Tax Deductions for Charitable Donations: A Tax Expenditure Analysis" in Richard Krever and Gretchen Kewley, eds., *Charities and Philanthropic Institutions: Reforming the Tax Subsidy and Regulatory Regimes*, (Melbourne: Australian Tax Research Foundation, 1991) 1 at 5-8.

<sup>22</sup> Boris I. Bittker, "The Propriety and Vitality of a Federal Income Tax Deduction for Private Philanthropy," in *Tax Impacts on Philanthropy*, Symposium conducted by the Tax Institute of America (Princeton: Tax Institute of America, 1972) 145 at 165. For a similar argument, see also Mark P. Gergen, "The Case for a Charitable Contribution Deduction" (1988), 74 *Va. L. Rev.* 1393 at 1426-33.

deductible in computing a taxpayer's income.<sup>23</sup> In contrast, where a taxpayer donates cash or property to a charitable organization for the purpose of earning income, this donation is properly deductible in computing the taxpayer's income as an ordinary business expense.

## B. Rewarding Generosity

As an alternative to the accurate measurement of income rationale, tax recognition for charitable contributions is also favoured on the basis that it rewards generosity as a form of virtuous behaviour. In addition to other arguments for a charitable deduction, for example, Bittker suggests that “something can be said for rewarding activities that in a certain sense are selfless, even if the reward serves no incentive function.”<sup>24</sup> Similarly, Richard Goode has referred to the U.S. deduction for charitable contributions as a “reward” for charitable giving.<sup>25</sup>

As a reward for the donor's generosity, tax recognition for charitable contributions should logically take the form of a tax benefit the value of which is

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<sup>23</sup> See, e.g., Gwyneth McGregor, “Charitable Contributions” (1961), 9 *Can. Tax J.* 441 at 442 (“Charitable contributions ... are not a vital necessity of life and are voluntary”); Edward H. Rabin, “Charitable Trusts and Charitable Deductions” (1966), 41 *N.Y.U.L. Rev.* 912 at 915 (“the charitable deduction exists almost solely to encourage charitable giving, not to relieve hardship caused by ‘involuntary’ expenses”); James A. Rendall, “Taxation of Contributors to Charitable Organizations Under the *Income Tax Act*,” in *Report of the Proceedings of the Twenty-Fifth Tax Conference, 1973 Conference Report*, (Toronto: Canadian Tax Foundation, 1974) 152 at 153 (characterizing charitable contributions as “consumption”); Boadway and Kitchen, *Canadian Tax Policy*, *supra* note 12 at 71 (contrasting medical expenses, “which are almost always involuntary,” with charitable donations, which “are not a vital necessity of life and tend to be made on a voluntary basis”); and Ellen P. Aprill, “Churches, Politics, and the Charitable Contribution Deduction” (2000-2001), 42 *B.C.L. Rev.* 843 at 870 (“charitable contributions are made voluntarily, as a discretionary use of income”).

<sup>24</sup> Bittker, “The Propriety and Vitality of a Federal Income Tax Deduction,” *supra* note 22 at 166.

<sup>25</sup> Goode, *The Individual Income Tax*, *supra* note 10 at 165.

geared in some way to a measure of the donor's relative sacrifice.<sup>26</sup> Given statistics indicating that low-income donors tend to give a larger percentage of their incomes to charities than high-income taxpayers,<sup>27</sup> therefore, this rationale for tax recognition suggests that a deduction, the value of which increases as the donor's income rises, has the reward structure backwards. Instead, assuming a diminishing marginal utility of income, one might favour a benefit that decreases as the donor's income increases. Neil Brooks, for example, has suggested that a tax credit for charitable contributions "could be set at 30 per cent for those with incomes over \$35,000; 40 per cent for those with incomes from \$25,000 to \$35,000, and so on, down to those with incomes under \$10,000, where the credit might be set at 100 per cent."<sup>28</sup> To the extent that a donor's relative sacrifice depends on the wealth as

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<sup>26</sup> See, e.g., Paul R. McDaniel, "Federal Matching Grants for Charitable Deductions: A Substitute for the Income Tax Deduction" (1972), 27 *Tax Law Rev.* 377 at 394 ("if there is to be a reward for charitable giving, the incidence and amount of the reward should bear some rational relationship to the act of charitable giving. The reward should be the same for persons who make a similar sacrifice, however measured.").

<sup>27</sup> See, e.g., Richard M. Bird and Meyer W. Bucovetsky, *Canadian Tax Reform and Private Philanthropy*, Tax Paper No. 58 (Toronto: Canadian Tax Foundation, 1976) at 18 (Table 18) (reporting for the 1972 taxation year that for taxpayers claiming charitable contributions, the percentage of average income among different income groups was 7.8 percent for donors with incomes less than \$5,000, 4.1 percent for donors with incomes of \$5,000 to \$10,000, 2.9 percent for donors with incomes of \$10,000 to \$20,000, 2.4 percent for donors with incomes of \$20,000 to \$50,000, 2.4 percent for donors with incomes of \$50,000 to \$100,000, and 3.6 percent for donors with incomes exceeding \$100,000). More recent figures from the 1990 taxation year, demonstrate a similar U-shaped ratio of charitable donations to income level of donors, falling from 4.1 percent for donors with taxable incomes less than \$10,000 to 2.1 percent for donors with taxable incomes of \$10,000 to \$30,000, 1.4 percent for donors with taxable incomes of \$30,000 to \$50,000, 1.3 percent for donors with taxable incomes of \$50,000 to \$100,000, 1.7 percent for donors with taxable incomes of \$100,000 to \$250,000, and 1.9 percent for donors with taxable incomes exceeding \$250,000. Calculated from figures in Revenue Canada, *Taxation Statistics on Individuals: 1990 Tax Year*, (Ottawa: Minister of Supply and Services, 1992).

<sup>28</sup> Neil Brooks, *Financing the Voluntary Sector: Replacing the Charitable Deduction*, (Toronto: Law and Economics Workshop Series, Faculty of Law, University of Toronto) at 24.

well as income, moreover, one might imagine a tax benefit that decreases as the donor's wealth and income increase.

Alternatively, the amount of the tax benefit might vary according to the percentage of the taxpayer's annual income and/or wealth that the taxpayer contributes to eligible recipients during the year.<sup>29</sup> On this basis, for example, Paul McDaniel has proposed a matching grant for charitable donations which would rise from 5 percent of aggregate donations from donors contributing less than 2 percent of their incomes to charities to 50 percent of aggregate donations from donors contributing more than 10 percent of their incomes to charities.<sup>30</sup> For similar reasons, others have advocated a floor on any tax recognition for charitable contributions, set at a fixed percentage of each taxpayer's income for the year.<sup>31</sup> In 1969, for example, the U.S. Treasury Department proposed that the charitable deduction in the U.S. Internal Revenue Code be available only for contributions exceeding 3 percent of the donor's income.<sup>32</sup> Likewise, the Canadian Royal Commission on Taxation (Carter Commission) considered, but rejected, a floor set at 1 percent of the donor's income.<sup>33</sup> Besides targeting the "reward" to the most

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<sup>29</sup> See, e.g., McDaniel, "Federal Matching Grants" *supra* note 26 at 394 (arguing that the reward rationale "appears to call for a system which increases the reward as the individual sacrifices a greater proportion of his income to charity").

<sup>30</sup> *Ibid.* at 397.

<sup>31</sup> See, e.g., Bittker, "The Propriety and Vitality of a Federal Income Tax Deduction," *supra* note 22 at 169 (suggesting that the floor should exclude the least generous 10 or 20 percent of donors); and Goode, *The Individual Income Tax*, *supra* note 10 at 165 (explaining that such a measure would "focus the reward or incentive more sharply by withdrawing the deduction from persons whose contributions are small relative to income while continuing it for heavier contributions.").

<sup>32</sup> See the discussion of this proposal in McDaniel, "Federal Matching Grants" *supra* note 25 at 387-88.

<sup>33</sup> *Report of the Royal Commission on Taxation*, vol. 3 (Ottawa: Queen's Printer, 1966) at 224.

generous contributors, such a floor would also reduce administrative costs associated with tax assistance for charitable giving.<sup>34</sup>

Although a reward rationale for the tax recognition of charitable contributions suggests a number of possible methods for this recognition, the rationale itself is deeply problematic. While generosity is undoubtedly worthy of praise, it is not clear that it merits monetary rewards. On the contrary, as critics from radically different philosophical perspectives have observed, to reward generosity through monetary means contradicts the spirit underlying the virtue of generosity, “corrupt[ing] the essential dignity and altruism of a simple gift,”<sup>35</sup> and “accentuat[ing] the purely selfish goal of reducing one’s own taxes.”<sup>36</sup> Moreover, as John Colombo suggests, “the work of social scientists may indicate that providing a material reward for giving may actually decrease the giving rate where part of what individuals want from their donation is the ‘warm glow’ and increased self-esteem from behaving altruistically.”<sup>37</sup> As a result, as a rationale for the tax recognition of charitable contributions, the reward rationale is no more persuasive than the

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<sup>34</sup> See, e.g., Rendall, “Taxation of Contributors” *supra* note 23 at 159; and Goode, *The Individual Income Tax*, *supra* note 10 at 165. See also the discussion in Aprill, *supra* note 23 at 859-62 (proposing the idea of an income-related floor on deductible charitable contributions as a solution to administrative concerns with the extension of the deduction to non-itemizers in the U.S.).

<sup>35</sup> E. Blake Bromley, “Charity, Philanthropy and Stewardship: A Philosophical Perspective on Tax Reform” (1988), 7 *Philanthropist* 4 at 12.

<sup>36</sup> Neil Brooks, “The Tax Credit for Charitable Contributions: Giving Credit where None is Due” in Phillips, Chapman, and Stevens, eds., *Between State and Market*, *supra* note 5, 457 at 464. See also Gergen, “The Case for a Charitable Contribution Deduction” *supra* note 22 at 1394 (asking why, if a society values altruism, it would want to “sully” this virtue with “a pecuniary reward”).

<sup>37</sup> John D. Colombo, “The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and Tax Exemption” (2001), *Wake Forest L. Rev.* 657 at 677.

argument that a deduction is necessary to ensure an accurate measure of taxable income.

### **C. Subsidizing Charitable Activities**

A third rationale for the tax recognition of charitable contributions is to provide an indirect subsidy to charitable activities by encouraging charitable gifts. To the extent that charitable giving is what economists describe as a “normal good”, tax incentives for charitable gifts will increase their quantity by decreasing their after-tax cost to the donor.<sup>38</sup> By increasing aggregate contributions to charitable organizations, it follows, these incentives provide an indirect subsidy to the charitable sector.

In order to evaluate the merits of this argument, it is necessary to examine both the initial justification for subsidizing the charitable sector, and the reasons why indirect subsidies delivered in the form of tax incentives might be preferred to direct subsidies to charitable organization in the form of sustaining or matching grants. On this basis, finally, it is useful to consider the implications of this rationale for the manner in which a tax incentive for charitable contributions might reasonably be designed.

#### ***1. Public Benefits and the Charitable Sector***

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<sup>38</sup> As economic analysis suggests, this response is a product of the “income effect” which increases the donor’s after-tax income from which gifts may be made, and the “substitution effect” which reduces the after-tax cost of these gifts compared to other expenditure items. See Michael K. Taussig, “Economic Aspects of the Personal Income Tax Treatment of Charitable Contributions” (1967), 20 *Nat. Tax J.* 1 at 3 (explaining that: “Only the price or substitution effect ... can be properly regarded as the result of ... the ... policy variable, since the income effect ... is incidental and could be achieved equally well by a cut in tax rates, an increase in personal exemptions, and by similar alternative devices.”).

Among economists, the charitable sector is generally regarded as a provider of quasi-public goods and services – the essential characteristics of which are non-rivalness, meaning that enjoyment by one person does not preclude enjoyment by another, and non-excludability, meaning that it is difficult or impossible to exclude a person from enjoying the benefit even if he or she refuses to pay for it.<sup>39</sup> Where a good or service is relatively non-rival and/or non-excludable, economic theory suggests that private markets will either oversupply the good or service (in the case of non-rival but excludable goods and services) or undersupply the good or service (in the case of non-excludable goods or services). In either case, the resolution of these “market imperfections” is one of the main economic justifications for the existence of a public sector which provides these public goods and services directly, distributing their costs among individual beneficiaries through taxes and other levies.<sup>40</sup>

In addition to the public sector, the charitable sector represents another response to the existence of market imperfections, providing various goods and services such as education, culture, and religion, the benefits of which are relatively non-rival and/or non-excludable. Indeed, since charitable organizations enable individuals to select a range of public goods and services corresponding to their

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<sup>39</sup> See, e.g., Kimberley Scharf, Ben Cherniavsky and Roy Hogg, *Tax Incentives for Charities in Canada*, Working Paper No. CPRN 03, (Ottawa: Canadian Policy Research Networks, 1997) at 4-5.

<sup>40</sup> In addition to this economic justification for the existence of a public sector, public finance scholars typically identify as other “fiscal functions” the “distribution function” to moderate inequalities in the distribution of market outcomes, and the “stabilization function” to moderate macroeconomic fluctuations associated with the business cycle. See, e.g., Richard A. Musgrave, Peggy B. Musgrave, and Richard M. Bird, *Public Finance in Theory and Practice*, 1st Cdn. ed. (Toronto: McGraw-Hill Ryerson, 1987).

own values and preferences, this sector may have distinct advantages over the broader public sector in providing a mix of such goods and services that are more compatible with the demands of a diverse society.<sup>41</sup> Furthermore, to the extent that the charitable sector is more innovative and service-oriented than the traditional public sector, it may provide a more efficient vehicle for the delivery of certain public goods and services.<sup>42</sup> As well, by relieving the public sector from sole responsibility for providing public goods and services, the charitable sector lessens the fiscal burdens of the public sector, making it better able to perform the important redistributive, allocative and stabilization functions that only it can effectively fulfill.<sup>43</sup>

For all of these reasons, a good argument can be made that the public sector should provide financial support to charitable organizations. Where charitable organizations provide alternative methods of delivering public goods and services to those employed by the traditional public sector, this quasi-public function should

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<sup>41</sup> See, e.g., Lester M. Salamon, "Partners in Public Service: The Scope and Theory of Government-Non-profit Relations," in Walter Powell, ed., *The Non-profit Sector: A Research Handbook* (New Haven, Conn.: Yale University Press, 1987) 99. See also Krever, "Tax Deductions for Charitable Donations," *supra* note 21 at 8-13.

<sup>42</sup> See, e.g., Scharf, Cherniavsky and Hogg, *Tax Incentives for Charities in Canada*, *supra* note 39 at 5 (suggesting that "voluntary organizations foster a do-it-yourself culture, which can improve accountability, encourage technological innovation, and promote efficiency in the use of resources, which may be more desirable if government provision is encumbered with a lot of bureaucracy."). See also Richard Domingue, *The Charity "Industry" and its Tax Treatment*, (Ottawa: Minister of Supply and Services, 1995) at 3 (arguing that: "At a time when attempts are being made to reinvent government, it should perhaps be recognized that social services could be provided much more efficiently by charitable organizations. It could be that communities and local agencies are in a better position to assess and meet these needs economically than government employees working in a capital city far removed from the people they serve.").

<sup>43</sup> See, e.g., McGregor, "Charitable Contributions," *supra* note 23 at 442 (noting that charitable contributions "relieve the government of some of its responsibilities, and make possible some activities, such as those of a cultural nature, which the government might not feel impelled, or be able, to afford to carry on.").

be supported by public funds. To the extent that charitable organizations provide quasi-public goods and services, moreover, economic theory supports the subsidization of these activities in order to prevent their undersupply.<sup>44</sup>

## 2. *Tax Incentives versus Direct Subsidies*

Assuming that public subsidies for the charitable sector are justified, however, it does not necessarily follow that these subsidies should be delivered in the form of tax incentives directed at persons making donations to charitable organizations rather than directly to the organizations themselves. Indeed, critics of tax incentives for charitable contributions have raised two objections to these indirect subsidies as a way to provide financial support to the charitable sector: first, that tax incentives are an inefficient way to subsidize charitable organizations, costing more in foregone revenues than they produce in increased contributions; and second, that tax expenditures for charitable contributions lack the rationality, controllability, accountability, and transparency associated with direct government expenditures.<sup>45</sup> Notwithstanding these objections, however, it is my view that the social and cultural pluralism that sustains the charitable sector favours indirect subsidies in the form of tax incentives either instead of, or in addition to, direct grants.<sup>46</sup>

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<sup>44</sup> See Harold M. Hochman and James D. Rodgers, "The Optimal Tax Treatment of Charitable Contributions" (1977), 30 *Nat. Tax. J.* 1 at 2-3. See also Gergen, "The Case for a Charitable Contribution Deduction," *supra* note 22 at 1396-1414.

<sup>45</sup> See, e.g., Rabin, *supra* note 23 at 918-25; and Brooks, "The Tax Credit for Charitable Contributions," *supra* note 36 at 467-72.

(a) *Efficiency*

The cost-effectiveness of a tax incentive for charitable contributions as opposed to direct government subsidies depends on the extent to which the aggregate amount of charitable gifts increases in response to a decrease in their after-tax cost as a result of the incentive – a relationship that economists describe as the “price elasticity of giving”.<sup>47</sup> Since reductions in the after-tax cost of gifts are financed by foregone tax revenues, the price elasticity of charitable giving reflects the cost-effectiveness of the tax incentive as a means of funding the charitable sector. While a high price elasticity indicates that an increase in the aggregate amount of charitable donations attributable to the tax incentive exceeds the cost of the tax in terms of foregone revenues, a low price elasticity indicates that the foregone tax revenues attributable to the tax incentive exceed the resulting increase in the amount of charitable donations.

A voluminous literature has developed over the past thirty years as economists have attempted to obtain reliable estimates of the price elasticity of

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<sup>46</sup> Indeed, studies indicate that direct government funding constitutes a much larger (and increasing) share of the revenues of charitable organizations in Canada than donations. See, e.g., Kathleen M. Day and Rose Ann Devlin, *The Canadian Nonprofit Sector*, Paper No. CPRN 02, (Ottawa: Canadian Policy Research Networks, 1997) at 15-16 (reporting that the percentage of charitable organization revenues derived from government funding increased from 42.8 percent in 1989 to 60.2 percent in 1994 while the percentage of revenues from donations decreased from 21.8 percent in 1989 to 11.3 percent in 1994).

<sup>47</sup> For a useful introduction to this concept, see Scharf, Cherniavsky and Hogg, *Tax Incentives for Charities in Canada*, *supra* note 39 at 8-9. Briefly, a low price elasticity of charitable giving indicates a slight increase in the aggregate giving in response to a decrease in the after-tax cost of these gifts, while a high price elasticity of charitable giving implies that the quantity of charitable donations is highly responsive to changes in the after-tax cost of these gifts.

charitable giving.<sup>48</sup> Although the earliest studies reported relatively low price elasticities of charitable giving,<sup>49</sup> suggesting that tax incentives are a relatively inefficient means of funding charitable organizations,<sup>50</sup> subsequent studies reported price elasticities greater than negative one,<sup>51</sup> suggesting that tax incentives may be a cost-effective method of funding charitable organizations.<sup>52</sup> More recent studies using different methodologies have reported much lower estimates of price elasticities,<sup>53</sup> again calling into question the efficiency of tax incentives as a method

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<sup>48</sup> For summaries of this literature, see J.A. Johnson, “The Determinants of Charitable Giving with Special Emphasis on the Income Deduction under the Income Tax – A Survey of the Empirical Literature” (1981), 3 *Can. Taxation* 258; Charles T. Clotfelter, *Federal Tax Policy and Charitable Giving*, (Chicago: University of Chicago Press, 1985) at 16-99; Scharf, Cherniavsky and Hogg, *Tax Incentives for Charities in Canada*, *supra* note 39 at 11-17; and E. Brown, “Taxes and Charitable Giving: Is There a New Conventional Wisdom?” *National Tax Association, Proceedings, Eighty-Ninth Annual Conference* (Chicago: National Tax Association, 1996) 153.

<sup>49</sup> See, e.g., Taussig, “Economic Aspects,” *supra* note 38; Robert A. Schwartz, “Personal Philanthropic Contributions” (1970), 78 *J. Pol. Econ.* 1264; and R.D. Hood, S.A. Martin, and L.S. Osberg, “Economic Determinants of Individual Charitable Donations in Canada” (1977), 10 *Can. J. Econ.* 653.

<sup>50</sup> See, e.g., Rendall, “Taxation of Contributors,” *supra* note 23 at 158-59; Dennis B. Wolkoff, “Proposal for a Radical Alternative to the Charitable Deduction,” [1973] *Law Forum* 279 at 291-93; and Brooks, *Financing the Voluntary Sector*, *supra* note 28 at 18-21.

<sup>51</sup> See, e.g., Martin Feldstein, “The Income Tax and Charitable Contributions: Part I - Aggregate and Distributional Effects” (1975), 28 *Nat. Tax J.* 81; Charles T. Clotfelter and C. Eugene Steuerle, “Charitable Contributions,” in Henry J. Aaron and Joseph A. Pechman, *How Taxes Affect Economic Behavior*, (Washington, D.C.: Brookings Institution, 1980) 403; Harry Kitchen and Richard Dalton, “Determinants of Charitable Donations by Families in Canada: A Regional Analysis” (1990), 22 *App. Econ.* 285; and Harry Kitchen, “Determinants of Charitable Donations in Canada: A Comparison Over Time” (1992), 24 *Applied Econ.* 709.

<sup>52</sup> See, e.g., Scharf, Cherniavsky and Hogg, *Tax Incentives for Charities in Canada*, *supra* note 39 at 9 and 14.

<sup>53</sup> See, e.g., Richard Steinberg, “Taxes and Giving: New Findings” (1990), 1 *Voluntas* 76; Leonard E. Burman and William C. Randolph, “Measuring Permanent Responses to Capital-Gains Tax Changes in Panel Data” (1994), 84:4 *Am. Econ. Rev.* 794; William C. Randolph, “Dynamic Income, Progressive Taxes, and the Timing of Charitable Contributions” (1995), 103 *J. Pol. Econ.* 709; Kevin Stanton Barrett, Anya M. McGuirk, and Richard Steinberg, “Further Evidence on the Dynamic Impact of Taxes on Charitable Giving” (1997), 50 *Nat. Tax J.* 321; and Pamela Greene and Robert McClelland, “Taxes and Charitable Giving” (2001), 54:3 *Nat. Tax. J.* 443.

of funding the charitable sector.<sup>54</sup> On this basis, it has been argued, if governments were to repeal their tax incentives for charitable giving and distribute the revenue savings in the form of direct grants to charitable organizations, “the charitable sector would have considerable additional revenue.”<sup>55</sup>

*(b) Rationality, Controllability, Accountability, and Transparency*

A second objection to tax incentives as way of subsidizing charitable organizations is that these “tax expenditures” are not subject to the usual criteria applied to government spending – criteria including the rational allocation of resources among competing priorities, control over the total amount expended, accountability for these expenditures to Parliament and the electorate, and transparency in the goals, costs and beneficiaries of the expenditure.<sup>56</sup> With respect to the allocation of charitable gifts, for example, Neil Brooks concludes that:

Under the present tax credit for charitable contributions, the total level of expenditures to various medical research projects depend largely on competing public fund-raising drives. One could hardly imagine a less appropriate way to decide between – for example, muscular dystrophy, cancer, heart and stroke, trauma, and mental disability, say, than to base the decision on the “pay-off” from competing publicity campaigns.<sup>57</sup>

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<sup>54</sup> See, e.g., Brooks, “The Tax Credit and Charitable Contributions,” *supra* note 36 at 471-72 (concluding that “the best evidence tells us that the amount [of charitable giving stimulated by the Canadian tax credit] is considerably less than the government loses in revenue.... If the government were to repeal the tax credit and allocate the saved revenue through semi-autonomous government agencies to the voluntary sector, much of the charitable sector would have considerable additional revenue.”).

<sup>55</sup> *Ibid.* at 472.

<sup>56</sup> See, e.g., *ibid.* at 467-71. For leading criticisms of tax expenditures, see Surrey, *Pathways to Tax Reform*, *supra* note 22; and Stanley S. Surrey and Paul R. McDaniel, *Tax Expenditures*, (Cambridge, MA: Harvard University Press, 1985).

<sup>57</sup> Brooks, “The Tax Credit and Charitable Contributions,” *supra* note 36 at 467-68.

In addition, he suggests, unlike government spending, few people plan their charitable contributions:

Instead they respond to family or friends' medical histories, door-to-door collections, the availability of raffle tickets, or the sponsoring of someone in an event without seriously weighing the relative seriousness of the cause or the effectiveness of the particular charitable organization.<sup>58</sup>

With respect to the control of program costs, Brooks continues, tax incentives make it extremely difficult for the government to determine the total amount that it will have to spend, which will “depend on, among other things, any changes in the marginal tax rates, the enactment of other tax incentives, and the success of charities' appeals.”<sup>59</sup> On the questions of accountability and transparency, moreover, he notes that charities' activities are “seldom subject to public scrutiny” – making it possible, according to the Canadian Security Intelligence Service (CSIS), for “about two dozen charitable groups in Canada” to fund “world-wide terrorism and ethnic conflict” without public knowledge.<sup>60</sup>

*(c) Pluralism*

These objections pose serious challenges to an argument favouring tax incentives for charitable contributions as indirect subsidies to charitable organizations. Nonetheless, it is my view that they do not undermine the most basic rationale for such an incentive – to enable individuals to choose through their

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<sup>58</sup> *Ibid.* at 469.

<sup>59</sup> *Ibid.*

<sup>60</sup> *Ibid.* at 470.

donations the charitable activities to which they wish to direct a public subsidy.<sup>61</sup> To the extent that these indirect subsidies allow individuals to select the charitable activities to which they wish to direct public support without having to obtain the agreement of a political majority, they are generally preferable to direct sustaining grants in promoting the very diversity and innovation that accounts for the charitable sector's unique advantages to the traditional public sector. Indeed, in the absence of an all-knowing legislator who can rationally allocate all public revenues in the most rational and efficient way, there is often no better basis on which to subsidize charitable organizations than by the "votes" of charitable donors, however "rational" or "irrational" these votes may be.

As a result, even if tax incentives for charitable contributions are a less cost-effective method of subsidizing charitable organizations than direct government grants, there are good reasons to favour tax incentives on broader policy grounds.<sup>62</sup> Moreover, although it might be argued that direct matching grants are as consistent with pluralistic objectives as indirect tax expenditures, the latter are more likely

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<sup>61</sup> For a similar conclusion, see Krever, "Tax Deductions for Charitable Donations," *supra* note 21 at 11-13. For a more general discussion of the use of the tax system to vote on public spending decisions, see Saul Levmore, "Taxes as Ballots" (1998), 65 *U. Chi. L. Rev.* 387.

<sup>62</sup> See, e.g., Hochman and Rodgers, "The Optimal Tax Treatment of Charitable Contributions," *supra* note 44 at 11 ("Public policy involves much more than whether an additional dollar of subsidies can generate more than a dollar of charity."). See also Colombo, "The Marketing of Philanthropy," *supra* note 37 at 684, n. 128 (adding that estimates of the price elasticity of charitable giving may not provide an accurate measure of the relative cost-effectiveness of tax incentives and direct grants, since it is not obvious that governments would collect the taxes that are foregone by tax incentives, and indisputable that the collection and distribution of these revenues to charitable organizations would involve additional administrative and compliance costs that should also be taken into account in any efficiency analysis). On the other hand, any measure of the cost-effectiveness of indirect subsidies in the form of tax incentives should also account for administrative costs incurred by charitable organizations to obtain private donations and administrative and compliance costs associated with the incentives themselves.

than the former to withstand the kinds of political controls that would undermine their effectiveness in promoting pluralism.<sup>63</sup> For all these reasons, therefore, it is possible to justify the use of tax incentives as indirect subsidies for charitable organizations.

Pluralism, of course, has its limits, and the funding of terrorist organizations is clearly outside the scope of this rationale for an indirect subsidy in the form of a tax incentive for charitable contributions. Nonetheless, this outcome is not inconceivable where charitable organizations receive public funds through direct grants, nor inevitable where subsidies are delivered indirectly in the form of tax incentives. On the contrary, in either case, the key to ensuring that public funds are used for the public benefit lies in the regulation of the charitable sector through disclosure and reporting requirements and periodic audits.<sup>64</sup> Likewise for

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<sup>63</sup> See, e.g., Bittker, “The Propriety and Vitality of a Federal Income Tax Deduction,” *supra* note 22 at 147-52 (concluding that “I have very little confidence that a system of matching grants could be administered without administrative and congressional investigations, loyalty oaths, informal or implicit warnings against heterodoxy, and the other trappings of governmental support than the tax deduction has, so far, been able to escape”); Goode, *The Individual Income Tax*, *supra* note 10 at 163 (considering it “unlikely” that a system of direct matching grants “would be as free of undesirable controls or would serve the values of pluralism as well.”); John G. Simon, “Charity and Dynasty Under the Federal Tax System” (1978), 5 *Probate Lawyer* 1 at 82 (observing that “[t]he tax allowance method has at least the virtue that it does not call upon the government to play an active role in singling out the chosen few”); Krever, “Tax Deductions for Charitable Donations,” *supra* note 21 at 21-25 (concluding that “a matching grant system cannot effectively promote the values of pluralism. If pluralist decision making in the allocation of the government funds for charitable purposes is to be preserved, proposals to replace the current tax expenditure with a matching grant system must be viewed with suspicion.”); and Evelyn Brody, “Charities in Tax Reform: Threats to Subsidies Overt and Covert” (1999), 66 *Tenn. L. Rev.* 687 at 757 (suggesting that “one of the reasons why we use the indirect tax subsidy approach is that we are a very heterogeneous society. As such, we find it difficult to agree on which functions to subsidize.”)

<sup>64</sup> See, e.g., Lorne Sossin, “Regulating Virtue: A Purposive Approach to the Administration of Charities” in Phillips, Chapman, and Stevens, eds., *Between State and Market*, *supra* note 5, 373 at 388-89 (indicating among other things that only 0.75 percent of Canadian charities are audited on a regular basis). For a recent discussion of these issues, see Voluntary Sector Initiative Joint Regulatory Table, *Improving the Regulatory Environment for the Charitable Sector*, (August 2002).

governments, public accountability does not necessarily turn on whether funds are spent directly or indirectly. Indeed, the practice of publishing regular tax expenditure budgets makes the annual cost of tax incentives as much a matter of public record and debate as the annual cost of direct spending programs.<sup>65</sup>

### *3. Designing a Tax Incentive for Charitable Contributions*

If the purpose of a tax incentive for charitable contributions is to provide an indirect subsidy to non-governmental organizations (NGOs) that produce quasi-public goods and services, the design of the incentive should presumably advance this purpose. The elements of a tax incentive for charitable contributions include the kinds of recipients donations to which qualify for the tax incentive, the types of contributions for which the incentive is available, and the structure of the tax benefit available to those making qualifying contributions to eligible recipients. A further issue concerns the existence of any limit on the extent to which donors may claim the tax benefit.

#### *(a) Eligible Recipients*

Beginning with the kinds of recipients that should be eligible for tax-preferred donations, the rationale for the incentive should presumably define the scope of its application. To the extent that the incentive is intended to subsidize the production of quasi-public goods and services by NGOs, therefore, the incentive should in principle be available for any contribution to a non-governmental

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<sup>65</sup> For the most recent tax expenditure budget in Canada, see Department of Finance, *Tax Expenditures and Evaluations 2002*, (Ottawa: the department, 2002).

organization the activities of which involve the provision of quasi-public goods or services. Since the subsidy is designed to support only activities having a public benefit, however, it is reasonable to require eligible recipients to devote all of their resources to these activities or related activities having a public benefit, and reasonable to deny or revoke eligibility to organizations engaging in other activities that are either detrimental to the public good or carried on primarily for private advantage. In order to ensure public accountability for these tax expenditures, moreover, it seems reasonable to enforce these requirements by regular audits, and reasonable to require public reporting of revenues and disbursements by eligible recipients.<sup>66</sup>

Although arguably clear in the abstract, the application of these principles to actual organizations involves often subtle distinctions between the concepts of public benefit, public detriment, and private advantage. While these distinctions are often best drawn in the context of concrete cases, the pluralistic rationale for indirectly subsidizing charitable organizations through tax incentives suggests at least some guidelines for the interpretation of each of these concepts.

With respect to public benefits, for example, the pluralistic goals of the incentive suggest that these should be broadly defined to include economic and non-economic goods as well as non-majoritarian values. To the extent that pluralism itself is conceived as a public good, moreover, it seems reasonable to

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<sup>66</sup> For a balanced discussion of reporting requirements for the charitable sector, see Voluntary Sector Initiative Joint Regulatory Table, *supra* note 64 at 7-17.

extend the concept of a public benefit to include the advancement of alternative belief systems, both spiritual and ideological. On this basis, therefore, one might also favour a broad view of the “advancement of religion” as a charitable purpose,<sup>67</sup> and question the so-called “political purposes doctrine” which denies charitable status to organizations the purposes or activities of which aim at social change or promote a particular point of view.<sup>68</sup> Where the means or ends of this social change contradict the values of a free and democratic society, however, eligibility should be denied on the basis that the organization’s purposes or

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<sup>67</sup> For a thorough examination of this issue in Canadian law, see Jim Phillips, “Religion, Charity, and the Charter,” in Phillips, Chapman, and Stevens, eds., *Between State and Market*, *supra* note 5, 316 (discussing limitations in the Anglo-Canadian definition of “religion”, but concluding at 335 that any benefits from the pursuit of religious activities should be regarded as private and that: “In a secular age, there seems little justification for the state to assist the expression of that preference.”).

<sup>68</sup> For a discussion of this doctrine in the Canadian context, see Abraham Drassinower, “The Doctrine of Political Purposes in the Law of Charities: A Conceptual Analysis,” in Phillips, Chapman, and Stevens, eds., *Between State and Market*, *supra* note 5, 288 (accepting for the purposes of his analysis the distinction between charitable and political purposes, but regarding as charitable and not political advocacy for social change to advance minimal conditions of human dignity). For a recent effort by the Canadian revenue authorities to articulate the scope of the political purposes doctrine, see the CCRA’s Draft Information Circular, “Registered Charities – Political Activities” (2002 Concept Draft), available at [http://www.ccradrc.gc.ca/tax/charities/consultations/political\\_activities-e.html](http://www.ccradrc.gc.ca/tax/charities/consultations/political_activities-e.html). For a recent critique of the political purposes doctrine in the Canadian context, see Richard Bridge, “The Law of Advocacy by Charitable Organizations: The Case for Change” (2002), 21 *Estates, Trusts & Pensions Journal* 92.

activities are not beneficial but detrimental to the public good. Obvious examples include the practice or promotion of discrimination<sup>69</sup> or terrorism.<sup>70</sup>

As for the concept of private advantage, the purpose of the incentive to subsidize the provision of quasi-public goods and services suggests that recipient organizations should not be eligible where their aims and activities do not extend to a sufficiently large segment of the community to constitute a *public* benefit.<sup>71</sup> Nor should the organization qualify as an eligible recipient where it diverts any of its resources to the personal benefit of its officers or members, since this result would contradict the purpose of the subsidy to provide public resources for public benefits. Although the immediate beneficiaries of the organization's activities may be small in number, however, its aims and activities should qualify for recognition

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<sup>69</sup> See, e.g., *Bob Jones University v. United States*, 461 U.S. 574 (1983) (in which the U.S. Supreme Court denied charitable status to a non-profit private school with a racially discriminatory admissions policy). For a similar issue in the Canadian context, see *Canada Trust Co. v. Ontario Human Rights Commission* (1990), 74 OR (2d) 481 (C.A.) (in which the Court struck down discriminatory provisions in a charitable trust as offensive to public policy). For a useful discussion of this decision and the manner in which values reflected in the Canadian *Charter of Human Rights and Freedoms* should be used to disqualify organizations from charitable status, see Mayo Moran, "Rethinking Public Benefit: The Definition of Charity in the Era of the Charter," in Phillips, Chapman, and Stevens, eds., *Between State and Market*, *supra* note 5, 251. For a critical evaluation of the U.S. Treasury Department's power to deny or revoke charitable status on public policy grounds, see David A. Brennan, "The Power of the Treasury: Racial Discrimination, Public Policy, and 'Charity' in Contemporary Society" (2000), 33 *U.C. Davis L. Rev.* 389.

<sup>70</sup> See subsection 168(3) of the ITA, and paragraph 4(1)(a) of the *Charities Registration (Security Information) Act*, S.C. 2001, c. 41, s. 113 (which provide for the denial or revocation of charitable status where the Federal Court concludes on the basis of information presented to it – including intelligence information that need not be disclosed to the applicant or registered charity – that there are reasonable grounds to conclude that the applicant or registered charity "made ... or will make available any of its resources, directly or indirectly, to an organization or person" that engaged in or engages in "terrorism or activities in support of terrorism").

<sup>71</sup> See, e.g., *Verge v. Somerville*, [1924] A.C. 496 at 499 (P.C.), *per* Lord Wrenbury (concluding that in order to be charitable, an organization's purposes must be for "the benefit of the community or of an appreciably important class of the community"). This requirement was adopted by the Supreme Court of Canada in *Guaranty Trust Co. of Canada v. MNR*, [1967] S.C.R. 113 [hereafter *Guaranty Trust*], and *Vancouver Society of Immigrant and Visible Minority Women v. MNR*, [1999] 1 S.C.R. 10 [hereafter *Vancouver Society*].

where this targeted assistance furthers a broader public good. Such is the case, for example, with the traditional charitable purpose comprising the relief of poverty.<sup>72</sup>

*(b) Qualifying Contributions*

The second issue in designing a tax incentive for charitable donations concerns the kinds of contributions that should qualify for support. In this respect, at least two decisions must be made: one concerning the kinds of contributions for which the incentive is available; the other regarding the character of a charitable contribution as distinct from other non-qualifying transactions with charitable organizations.

With respect to the first of these questions, possible alternatives include one or more of the following: cash, property in kind, and services. While ease of administration might suggest that qualifying gifts should be limited to cash donations, which provide greatest flexibility to the eligible recipient and need not be valued in order to determine the amount of the tax benefit, the purpose of the tax incentive to indirectly subsidize eligible recipients seems to oppose any such distinction. On the contrary, to the extent that the incentive is intended to

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<sup>72</sup> *Commissioners for Special Purposes of the Income Tax v. Pemsel*, [1891] A.C. 531 at 583 (H.L.), Lord Macnaghten. The *Pemsel* classification of charitable purposes was approved by the Supreme Court of Canada in *Guaranty Trust*, *supra* note 71 at 141, and *Vancouver Society*, *supra* note 71 at para. 144.

subsidize charitable organizations, encouragement for gifts of property in kind and services is presumably also desirable.<sup>73</sup>

The second question is logically addressed by examining the consideration, if any, moving from the recipient to the donor. Since the purpose of the tax incentive is to subsidize eligible recipients, albeit indirectly, it should apply only to the extent that the value of the donor's gift exceeds the value of any consideration in return. Otherwise, the tax expenditure merely subsidizes the donor's personal consumption, without providing any economic benefit to the recipient organization. Where the consideration moving from the recipient to the donor is nominal or intangible, however, as with public acknowledgement of a donor's gift, the indirect subsidy rationale still applies, since the minimal cost of this consideration leaves the recipient organization with the economic benefit that the tax incentive is designed to provide.<sup>74</sup> Nor, it seems, should the donor's purpose in making the gift matter, so long as it confers an economic benefit on the recipient organization. Nonetheless, where the donor makes the gift for the purpose of producing income, it should not be possible to claim the same amount as a deduction as was claimed for the purpose of the tax incentive. Instead, the most

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<sup>73</sup> While some tax theorists object to any tax recognition for gifts of service on the basis that the donor obtains an implicit deduction through the non-taxation of the "imputed income" represented by the performance of services, this result is best explained in terms of a more basic principle against the taxation of imputed income from self-performed services. See the discussion in Duff, "Charitable Contributions and the Personal Income Tax," *supra* note 5 at 410. See also McDaniel, "Federal Matching Grants" *supra* note 26 at 396 (suggesting that "federal assistance could match contributions in services just as it could contributions in cash" if it is desired "to encourage volunteer work").

<sup>74</sup> For a contrary view, see Colombo, "The Marketing of Philanthropy," *supra* note 37 at 697-701 (arguing that the rationale for subsidization does not exist where the availability of this *quid pro quo* overcomes a "free-riding tendency" on the part of potential contributors).

logical approach would be to permit a deduction only for the net cost of the gift after deducting the amount of the tax benefit received on account of the incentive.<sup>75</sup>

*(c) Tax Benefit*

The third element in the design of a tax incentive for charitable contributions is the specific form that the tax benefit should take. Here too, the design of the incentive should presumably advance its underlying purpose to provide an indirect subsidy to non-governmental organizations producing quasi-public goods and services. More generally, to the extent that pluralism itself is regarded as a public good, the incentive should be designed to promote a diversity of organizations and perspectives by placing greater emphasis on the number of donors than the size of their donations.

Emphasizing the first of these objectives, some commentators have suggested that the amount of the tax benefit should vary according to the extent of the public benefit derived from the gift. According to Wayne Thirsk, for example:

... it would be desirable to disaggregate within an expenditure category and confer different rates of credit on items that contribute different amounts of social benefit. Not all charitable activities, for example, may yield the same

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<sup>75</sup> If the incentive took the form of a flat-rate credit of 40%, for example, a donor making a \$100 gift would obtain a credit of \$40, which would be subtracted from the amount of the gift to leave a deductible expense of \$60.

degree of social value, in which case a policy of differentiated tax credits is called for.<sup>76</sup>

On this basis, it follows, a tax incentive for charitable contributions should provide larger tax benefits for gifts to organizations the purposes and activities of which involve broader public benefits, and smaller tax benefits for gifts to organizations providing more localized benefits.

While this approach may be theoretically sound, and feasible in some contexts, it is likely to founder on the actual measurement of public benefits, which can depend on value judgments that are often difficult to reconcile.<sup>77</sup> More importantly, since an indirect subsidy in the form of a tax incentive is designed to promote pluralism in the allocation of public funds, any decision to favour some activities over others is arguably incompatible with the rationale for a tax incentive as opposed to direct government grants. Indeed, to the extent that pluralism itself is regarded as a public good, it follows that a tax incentive for charitable contributions should not discriminate among different activities or organizations,

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<sup>76</sup> Thirsk, "Giving Credit Where Credit is Due," *supra* note 10 at 41-42. See also Hochman and Rodgers, "The Optimal Tax Treatment of Charitable Contributions," *supra* note 44 at 14 (arguing that "[t]he proper level of the tax credit depends ... on the 'external' content of the benefits that the charity-financed activities confer; it depends, in other words, on the relationship between the marginal evaluations of the primary sharing group, namely voluntary donors, and the community-at-large."); and Scharf, Cherniavsky and Hogg, *Tax Incentives for Charities in Canada*, *supra* note 39 at 9 (suggesting that "we should try to encourage donations to charities that provide goods or services to a large number of consumers.").

<sup>77</sup> See, e.g., Wolkoff, "Proposal for a Radical Alternative," *supra* note 50 at 288 (most religious gifts "help maintain the donors' congregations" and are "directed at satisfying the needs of the donor, not at satisfying the needs of society at large."); and Bromley, "Charity, Philanthropy and Stewardship," *supra* note 35 at 14 ("Religious activities are justifiably 'charitable' on the basis that they are beneficial to the community as a whole because they contribute to bettering the conduct and character of citizens.").

except to deny charitable status to organizations the aims or activities of which contradict the values of a free and democratic society.

From this perspective, moreover, one might also question the structure of a deduction for charitable contributions, which differentiates among donors by providing a larger tax subsidy for contributions from high-income donors than low-income donors and no subsidy for contributions from donors whose incomes are too low to pay any tax. To the extent that charitable contributions operate as “votes” to direct public subsidies to the organizations of the donor’s choosing,<sup>78</sup> a deduction weighs the votes of high-income donors more heavily than those of lower-income donors and completely disenfranchises the lowest-income donors who pay no tax. Rather than promoting genuine pluralism, therefore, a deduction 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.

For this reason, therefore, a tax incentive for charitable contributions should ideally take the form of a tax credit or rebate the value of which does not vary according to the donor’s level of income.<sup>79</sup> In addition, the credit should be fully refundable in order to ensure that this subsidy is available not only for donations from donors with tax otherwise payable but also for contributions from donors

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<sup>78</sup> Levmore, “Taxes as Ballots,” *supra* note 61.

<sup>79</sup> For a similar argument to this effect, see Krever, “Tax Deductions for Charitable Donations,” *supra* note 21 at 19-21 and 25-26 (criticizing the “upside-down” character of a deduction and recommending a flat-rate “tax rebate” which “could be used to offset part of the taxpayer’s tax liability.”).

whose incomes are too low to pay tax.<sup>80</sup> As a further feature, the credit might include a declining rate structure based on the amount claimed, thereby promoting a more genuine pluralism by providing a larger subsidy for small and medium-sized donations and a smaller subsidy for large donations.<sup>81</sup> If this approach were adopted, however, it might also be necessary to prohibit the deduction of gifts made for the purpose of earning income.

*(d) Limit*

A final issue in the design of a tax incentive for charitable giving involves the existence of an overall limit on the amount that donors could claim every year. Since more affluent donors are able to make larger contributions to charitable organizations than donors with less income or wealth, a tax benefit that is based solely on the amount contributed allows more affluent donors to direct more public funds than less affluent donors to organizations of their choosing. In addition to a declining rate structure, therefore, a tax incentive for charitable contributions might reasonably to impose a limit on the maximum tax benefit that may be claimed.<sup>82</sup>

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<sup>80</sup> For similar arguments, see McDaniel, “Federal Matching Grants” *supra* note 26 at 391 (suggesting that society would be “greatly enhanced” by extending the pluralism of a tax incentive for charitable contributions to 100 percent of contributors); and Brooks, *Financing the Voluntary Sector*, *supra* note 28 at 23-24 (favouring a refundable tax credit).

<sup>81</sup> A good example might be the political contributions tax credit in subsection 127(3) of the Canadian ITA, which, although non-refundable, provides for a credit of 75% of the first \$200 contributed to a registered political party or candidate in a taxation year, 50% of the next \$350 contributed in the year, and 33<sup>1</sup>/<sub>3</sub>% of the next \$525, for a maximum credit against tax otherwise payable of \$500 on annual contributions of \$1,075.

<sup>82</sup> See, e.g., Brooks, *Financing the Voluntary Sector*, *supra* note 28 at 23-24 (“if the pluralism argument is to be taken seriously, the maximum tax credit available to each taxpayer should be limited.”).

One such approach, currently employed in Canada and the United States, would be to limit the aggregate amount of charitable contributions in respect of which a tax credit could be claimed to a fixed percentage of the donor's income for the year.<sup>83</sup> In this way, donors would be limited not only in the extent to which they could direct public funds to their preferred activities, but also in their ability to avoid all tax liability by making charitable gifts the aggregate value of which exceeds their annual income. As a result, as Peter Wiedenbeck explains, an income-related ceiling on total gifts that may be claimed "reflects a judgment ... that although charitable contributions are important and should be encouraged, every taxpayer should bear part of the burden of supporting the government."<sup>84</sup> In this respect, he adds, such a limit functions as "a mechanism to effectuate an appropriately limited consumer sovereignty over social service expenditures."<sup>85</sup>

While this approach might make sense for a tax incentive delivered in the form of a deduction or non-refundable credit, it seems incompatible with the main objective of a refundable credit to provide an equal tax benefit for charitable contributions made by all donors irrespective of their incomes. Since an income-related ceiling along these lines could limit the tax benefit available to donors with little or no taxable incomes, it could actually undermine the genuine pluralism that

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<sup>83</sup> In Canada, this percentage was originally set at 10 percent of the donor's income for the year, but was increased to 20 percent in 1972, 50 percent in 1996, and 75 percent in 1997. In the United States, the ceiling was originally 15 percent of the donor's income, but was subsequently increased to 50 percent. See the discussion of these ceilings in Duff, "Charitable Contributions and the Personal Income Tax," *supra* note 5 at 420-23.

<sup>84</sup> Peter J. Wiedenbeck, "Charitable Contributions: A Policy Perspective" (1985), 50 *Mo. L. Rev.* 85 at 115.

<sup>85</sup> *Ibid.* at 117.

a refundable tax credit is designed to promote. Instead, a more appropriate limit on the maximum tax benefit available under the incentive might be based on the aggregate amount donated over a specific period of time (e.g., up to \$10,000 of tax-assisted donations per year) or the amount of the benefit itself. In New Zealand, for example, the introduction of a new income tax in 1976 included a tax incentive for charitable contributions providing a credit of 50 percent up to a maximum tax saving of \$175.<sup>86</sup> To the extent that this limit prevents a donor's estate from claiming credits in the year of the donor's death, however, the incentive might reasonably permit a limited carryback for this purpose.

### III. Practice

As explained in the introduction to this paper, the Canadian income tax recognizes contributions to charitable organizations by permitting a deduction in computing the donor's net income where these gifts are made for the purpose of gaining or producing income from a business, a deduction in computing taxable income where the gift is made by a corporation, a non-refundable tax credit where the gift is made by an individual, and full or partial exemptions from capital gains tax otherwise payable where the subject matter of the gift consists of qualifying cultural property, publicly-traded securities, or ecologically sensitive land. While the first method of tax recognition is consistent with ordinary principles for the

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<sup>86</sup> Krever, "Tax Deductions for Charitable Donations," *supra* note 21 at 27.

computation of a taxpayer's income from a business, the others are best conceived as tax incentives or tax expenditures that provide an indirect subsidy to eligible recipients by encouraging donors to make qualifying gifts. The following sections examine the elements of the three tax incentives, considering the kinds of recipients donations to which are eligible for tax recognition, the types of gifts that qualify for tax recognition, and the structure of the tax benefit available under each incentive.<sup>87</sup>

### A. Eligible Recipients

Although different statutory rules govern the deduction for corporate donations, the credit for individual donations, and the full or partial capital gains exemptions for gifts of cultural property, publicly-traded securities, and ecologically sensitive land, all share similar definitions of eligible recipients. According to subsection 110.1(1) of the ITA, for example, corporations may claim a deduction in respect of the following categories of gifts:

- gifts of ecologically sensitive land (as certified by the Minister of the Environment) to “Her Majesty in right of Canada or a province or a municipality in Canada,” or to “a registered charity one of the main purposes of which is ... the conservation and protection of Canada’s heritage ...”;
- gifts of qualifying cultural property (as determined by the Canadian Cultural Property Export Review Board) other than ecologically sensitive land to “an institution or a public authority in Canada that was, at the time the gift was made, designated” as an eligible recipient

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<sup>87</sup> For a useful survey of these elements for the tax treatment of charitable contributions in Canada, see David P. Stevens, “Update on Charity Taxation” in *Report of the Proceedings of the Fifty-Third Tax Conference*, 2001 Conference Report (Toronto: Canadian Tax Foundation, 2002) 28:1-56.

under subsection 32(2) of the *The Cultural Property Export and Import Act*;

- gifts, other than gifts of ecologically sensitive land or qualifying cultural property, to “Her Majesty in right of Canada or a province” that were made before February 19, 1997; and

- gifts, other than gifts of ecologically sensitive land, gifts of qualifying cultural property, or gifts to the federal government or a province, to:

- (i) a registered charity,

- (ii) a registered Canadian amateur athletic association,

- (iii) a housing corporation resident in Canada that was “constituted exclusively for the purpose of providing low-cost housing accommodation for the aged, no part of the income of which was payable to, or was otherwise available for the personal benefit of, any proprietor, member or shareholder thereof”,

- (iv) a Canadian municipality,

- (v) the United Nations or an agency thereof,

- (vi) a university outside Canada that is prescribed to be a university the student body of which ordinarily includes students from Canada,

- (vii) a charitable organization outside Canada to which Her Majesty in right of Canada has made a gift in the year or in the 12-month period preceding the year, or

- (vii.1) Her Majesty in right of Canada or a province.

An identical list of eligible recipients appears in section 118.1 of the ITA, which governs the non-refundable credit for individual gifts. Similarly, ITA subparagraph 39(1)(a)(i.1), which exempts capital gains on gifts of qualifying cultural property, applies only where the gift is made to an institution or public authority designated *The Cultural Property Export and Import Act*, while ITA paragraphs 38(a.1) and

(a.2), which provide a partial exemption from capital gains on gifts of publicly-traded securities and ecologically sensitive land, apply only where the gift is made to a “qualified donee” (defined in ITA subsection 149.1(1) as all of the recipients listed above except the designated institution or public authority applicable for gifts of cultural property).

Of these eligible recipients, the most important category is a “registered charity”, which is defined in subsection 248(1) of the ITA as:

(a) a charitable organization, private foundation or public foundation, within the meanings assigned by subsection 149.1(1), that is resident in Canada and was either created or established in Canada, or

(b) a branch, section, parish, congregation or other division of an organization or foundation described in paragraph (a), that is resident in Canada and was either created or established in Canada and that receives donations on its own behalf

provided that the charitable organization or foundation “has applied to the Minister in prescribed form for registration, and is at that time registered as a charitable organization, private foundation or public foundation”. As a registered charity, a charitable organization or foundation is required to file an annual information return including schedules and financial statements disclosing the charity’s sources of income and the nature of its disbursements and expenditures.<sup>88</sup> Failure to file this return is grounds for revocation of charitable status.<sup>89</sup>

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<sup>88</sup> ITA, subsection 149.1(14). See Guide T4033 — Completing the Registered Charity Information Return (2001).

<sup>89</sup> ITA, paragraph 168(1)(c).

Section 149.1 of the ITA contains the statutory rules defining charitable organizations and foundations. According to definitions in subsection 149.1(1), a “charitable organization” means an organization, whether or not incorporated:

- (a) all the resources of which are devoted to charitable activities carried on by the organization itself,
- (b) no part of the income of which is payable to, or is otherwise available for, the personal benefit of any proprietor, member, shareholder, trustee or settlor thereof, [and]
- (c) more than 50% of the directors, trustees, officers or like officials of which deal with each other and with each of the other directors, trustees, officers or officials at arm’s length...

while a “charitable foundation” means

a corporation or trust that is constituted and operated exclusively for charitable purposes, no part of the income of which is payable to, or otherwise available for, the personal benefit of any proprietor, member, shareholder, trustee or settlor thereof, and that is not a charitable organization.

A charitable foundation is classified as a “public foundation” where a majority of the foundation’s “directors, trustees, officers or other like officials” deal with each other and with the other such officials at arm’s length, provided that no more than 50% of the foundation’s capital was contributed either by a single person or by members of a group who do not deal with each other at arm’s length.<sup>90</sup> Otherwise, the charitable foundation is classified as a “private foundation”. Because the

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<sup>90</sup> For foundations registered before February 16, 1984, the limit on contributions of capital by a single person or group of persons not dealing with each other at arm’s length is 75% rather than 50%.

opportunities for abuse are greater, private foundations are subject to a more stringent regulatory requirements than public foundations.<sup>91</sup>

Whereas the distinction between a public and private foundation turns on the extent to which it is controlled by a single person or related group, the distinction between a charitable organization and a charitable foundation generally turns on the manner in which they engage in charitable pursuits. As a general rule, charitable organizations must devote their resources to “charitable activities” that they themselves carry on, although subsection 149.1(6) relaxes this requirement by considering a charitable organization to be devoting its resources to charitable activities carried on by it where it carries on a related business, disburses not more than 50% of its income to qualified donees, or disburses income to a registered charity with which it is “associated”.<sup>92</sup> In contrast, charitable foundations are merely required to operate for “charitable purposes” – a term which subsection 149.1(1) specifically defines to include “the disbursement of funds to qualified donees”. In general, therefore, charitable organizations engage in charitable activities themselves, while charitable foundations operate for charitable purposes by disbursing funds to charitable organizations and other qualified donees.

Notwithstanding these differences between charitable organizations and charitable foundations, the ITA requires both types of registered charity to be “exclusively charitable” – devoting “all” of their “resources” to charitable activities

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<sup>91</sup> See ITA, subsections 149.1(3) and (4) which list various circumstances in which the Minister may revoke the registration of a public foundation or a private foundation.

in the case of charitable organizations, and operating “exclusively” for charitable purposes in the case of charitable foundations. Where a charitable foundation or organization devotes “substantially all of its resources” to charitable purposes (in the case of a charitable foundation) or charitable activities carried on by it (in the case of a charitable organization), however, ITA subsections 149.1(6.1) and (6.2) permit the charity to devote part of its resources to “political activities”, provided that they are “ancillary and incidental” to the foundation’s purposes or the organization’s activities and “do not include the direct or indirect support of, or opposition to, any political party or candidate for public office”.<sup>93</sup> More generally, judicial decisions have held that the pursuit of purposes that are not themselves charitable, but “incidental to” or “a means to the fulfillment of” other charitable purposes will not deprive an organization or foundation of charitable status.<sup>94</sup>

Since the ITA does not, aside from these provisions, define the terms “charitable activities” and “charitable purposes”, Canadian courts have generally sought guidance in the common law of trusts, which admits charitable purpose

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<sup>92</sup> According to ITA, subsection 149.1(7), the Minister may on application designate a registered charity as a charity associated with one or more registered charities where “the Minister is satisfied that the charitable aim or activity of each of the registered charities is substantially the same ....”

<sup>93</sup> The CCRA considers that a charity can devote as much as 10% of its resources to political activities and still satisfy the requirement that “substantially all of its resources” be devoted to purely charitable activities. Recognizing that this policy “may have a regressive impact on smaller charities” whose ability to conduct ancillary political activities may be thus limited, the Agency proposes to be more forgiving of smaller charities by increasing the threshold to 20% for registered charities with annual incomes of less than \$50,000, 15% for those with incomes between \$50,000 and \$100,000, and 12% for those with incomes between \$100,000 and \$200,000. Draft Information Circular, “Registered Charities – Political Activities” *supra* note 68, para. 11. The CCRA is also willing to accommodate organizations whose relative political spending may spike in a particular year if the average over several years would be within the parameters. *Ibid.*, para. 12.

trusts as an exception to the general rule that a purpose trust is invalid. Although the definition of a charitable organization mentions charitable activities, not purposes, the Supreme Court of Canada has downplayed the distinction, stating that “it is really the purpose in furtherance of which an activity is carried out, and not the character of the activity, that determines whether or not it is of a charitable nature.”<sup>95</sup> Where an organization is established for a charitable purpose, however, the Court has also emphasized that it is necessary to consider the activities carried on by the organization in order to ensure that they are “in furtherance of” the charitable purpose.<sup>96</sup>

The traditional starting point for judicial interpretations of charitable purposes is Lord Macnaghton’s statement in *Commissioners for Special Purposes of the Income Tax v. Pemsel*,<sup>97</sup> that:

“Charity” in its legal sense comprises four principal divisions: trusts for the relief of poverty; trusts for the advancement of education; trusts for the advancement of religion; and trusts for other purposes beneficial to the community, not falling under any of the preceding heads.

Superimposed on these categories, however, is a further requirement that the purpose of the trust must be “[f]or the benefit of the community or of an appreciably important class of the community.”<sup>98</sup> Although applicable to each of

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<sup>94</sup> *British Launderers’ Research Association v. Borough of Hendon Rating Authority*, [1949] 1 K.B. 462 (C.A.), cited with approval by the Supreme Court of Canada in *Guaranty Trust*, *supra* note 71 at 143.

<sup>95</sup> *Vancouver Society*, *supra* note 71 at para. 152.

<sup>96</sup> *Ibid.* at para. 194.

<sup>97</sup> [1891] A.C. 531 at 583 (H.L.) [hereafter *Pemsel*].

<sup>98</sup> *Verge v. Somerville*, *supra* note 71 at 499, cited with approval in *Guaranty Trust*, *supra* note 71 at 141.

the *Pemsel* categories, this additional requirement is particularly relevant to the fourth category “other purposes beneficial to the community” since, as Gonthier J. (dissenting) suggested in *Vancouver Society of Immigrant and Visible Minority Women v. MNR*, “under the first three heads, public benefit is essentially a rebuttable presumption, whereas under the fourth head it must be demonstrated”.<sup>99</sup>

In determining whether a purpose is charitable under the fourth head, however, English and Canadian courts have held that it necessary to determine not only whether the purpose is of benefit to the community but also whether it is beneficial “in a way that the law regards as charitable”.<sup>100</sup> For this purpose, moreover, they have generally referred to the preamble of the *Charitable Uses Act, 1601*,<sup>101</sup> commonly called the *Statute of Elizabeth*, which listed a number of activities regarded as charitable at the time.<sup>102</sup> Traditionally, courts and commentators have often emphasized the “spirit and intendment” of the

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<sup>99</sup> *Vancouver Society*, *supra* note 71 at para. 41.

<sup>100</sup> *D’Aguiar v. Guyana Commissioner of Inland Revenue*, [1970] T.R. 31 (P.C.) [hereafter *D’Aguiar*], cited with approval in *Vancouver Society*, *supra* note 71 at para. 177. Among the reasons why the Court affirmed this additional requirement in the *Vancouver Society* case is the need to distinguish between “charitable organizations”, donations to which are eligible for a corporate deduction or individual credit, and “non-profit organizations” which are tax-exempt but not eligible recipients for the purpose of the deduction or credit. Since ITA paragraph 149(1)(l) defines a non-profit organization as a non-charitable “club, society or association” that was “organized and operated exclusively for” among other things “social welfare”, the Court concluded that the statutory distinction between charitable and non-profit organizations would collapse if “public benefit” alone were to qualify as a charitable purpose under the fourth category in *Pemsel*.

<sup>101</sup> 43 Eliz. 1, c. 4.

preamble,<sup>103</sup> and have attempted to articulate a common principle to the preamble's list of charitable activities.<sup>104</sup> In contrast, most modern judicial decisions proceed on an incremental basis, considering the "trend" of judicial decisions regarding objects as charitable under this category and asking "whether, by reasonable extension or analogy, the instant case may be considered to be in line with these."<sup>105</sup> This incremental approach is extremely resistant to evolutionary expansion, however, as illustrated by the majority decision in the *Vancouver Society*<sup>106</sup> which denied charitable status under the fourth heading to a society established devoted to helping immigrant women find employment or self-

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<sup>102</sup> A modern rendition of the charitable activities listed in the preamble appears in *McGovern v. Attorney General*, [1982] Ch. 321 at 332, as follows: "The relief of aged, impotent, and poor people; the maintenance of sick and maimed soldiers and mariners, schools of learning, free schools, and scholars in universities; the repair of bridges, ports, havens, causeways, churches, seabanks, and highways; the education and preferment of orphans; the relief, stock, or maintenance of houses of correction; marriage of poor maids; supportation, aid, and help of young tradesmen, handicraftsmen, and persons decayed; the relief or redemption of prisoners or captives; and the aid or ease of any poor inhabitants concerning payment of fifteens, setting out of soldiers, and other taxes."

<sup>103</sup> See, e.g., *National Anti-Vivisection Society v. Inland Revenue Commissioners*, [1948] AC 31 (H.L.) at 63-64, cited with approval in *Native Communications Society of B.C. v. MNR*, [1986] 2 C.T.C. 170, 86 D.T.C. 6353 (F.C.A.) at 6357 (DTC).

<sup>104</sup> See, e.g., Spencer G. Maurice and David B. Parker, *Tudor on Charities*, 7th ed., (London: Sweet & Maxwell, 1984) at 90-91 (concluding that "general public utility, with the strongest emphasis on the adjective 'general', was the charitable characteristic possessed in common by the purposes recited in the preamble"); E. Blake Bromley, "Contemporary Philanthropy – Is the Legal Concept of 'Charity' Any Longer Adequate?" in Donald W.M. Waters, ed., *Equity, Fiduciaries and Trusts 1993*, (1993), 59 at 65-66 (suggesting that the preamble is best viewed as an agenda for social improvement); and Gonthier J.'s dissenting judgment in *Vancouver Society*, *supra* note 71 at para. 37 (proposing as common principles of all charities: "(1) voluntariness (or ... altruism, that is, giving to third parties without receiving anything in return other than the pleasure of giving); and (2) public welfare or benefit in an objectively measurable sense").

<sup>105</sup> *D'Aguiar*, *supra* note 100 at 33, cited with approval by Iacobucci J. in *Vancouver Society*, *supra* note 71 at para. 177.

<sup>106</sup> *Supra* note 71.

employment<sup>107</sup> notwithstanding earlier cases which had sanctioned charitable trusts for the purpose of aiding in the settlement of poor or persecuted immigrants.<sup>108</sup> As Mayo Moran and Jim Phillips have observed: “If one cannot move from poor or persecuted immigrants to female visible minority immigrants (let alone immigrants generally) one cannot get very far through analogy.”<sup>109</sup>

For the purposes of this paper, there is no need to examine the other *Pemsel* categories in detail, nor to review Canadian cases on the legal definition of charity.<sup>110</sup> In general, recent decisions have adopted expansive interpretations of the categories “relief of poverty” and “advancement of education”,<sup>111</sup> though the latter does not extend to public education and advocacy that is designed to

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<sup>107</sup> Although considering the Society’s purposes non-charitable under the fourth category, the majority regarded its purposes charitable under an expansive view of the second category involving the “advancement of education”. Notwithstanding this conclusion, it denied the Society charitable status on the basis that it was not clear that “all of its resources” would be devoted to this charitable purpose: *Vancouver Society*, *supra* note 71 at para. 205.

<sup>108</sup> See, e.g., *In re Wallace*, [1908] V.L.R. 636 (S.C.) (trust to pay passage money to immigrants from an English town to Melbourne); *Re Stone* (1970), 91 W.N. (N.S.W.) 704 (trust for the promotion of Jewish settlement in Israel); and *Re Morrison* (1967), 111 Sol. Jo. 758, 117 New L.J. 757 (Ch. D.) (trust for the assistance of refugees).

<sup>109</sup> Mayo Moran and Jim Phillips, “Charity and the Income Tax Act: The Supreme Court Speaks,” in Phillips, Chapman, and Stevens, eds., *Between State and Market*, *supra* note 5, 343 at 364. For other commentaries on the decision, see Deborah J. Lewis, “A Principles Approach to the Law of Charities in the Face of Analogies, Activities and the Advancement of Education” (2000), 25 *Queen’s L.J.* 679; David Stevens, “*Vancouver Society of Immigrant and Visible Minority Women v. M.N.R.*” (2000), 15:2 *The Philanthropist* 4; Arthur B. Drache, “*Vancouver Immigrant Women: The First Judicial Interpretation*” (2000), 15:2 *The Philanthropist* 14; and Wolfe D. Goodman, “A Personal View of the *Vancouver Society* Decision” (2000), 15:2 *The Philanthropist* 20.

<sup>110</sup> For a detailed discussion of the *Pemsel* categories, see Ontario Law Reform Commission, *Report on the Law of Charities*, (Toronto: Ontario Law Reform Commission, 1996) at 159-228. See also Inquiry into the Definition of Charities and Related Organizations, *Report*, (Canberra: Commonwealth of Australia, 2001). For a useful survey of Canadian cases on the law of charity, see Jim Phillips, “The Federal Court of Appeal and the Legal Meaning of Charity: Review and Critique,” in Phillips, Chapman, and Stevens, eds., *Between State and Market*, *supra* note 5, 219.

promote a particular point of view.<sup>112</sup> With respect to the third category “advancement of religion”, the courts adhere to a traditional conception, generally insisting on the existence of a “deity” and distinguishing between religion proper and “ethical systems of belief”.<sup>113</sup> Consistent with ITA subsections 149.1(6.1) and (6.2), moreover, which permit “ancillary and incidental” political activities, Canadian courts distinguish between charitable and political activities and purposes, denying charitable status where the activities or purposes of the organization or foundation advocate social change or promote a particular point of view.<sup>114</sup> Finally, new subsection 168(3) of the ITA provides for the revocation of charitable status where a Federal Court determines that there are reasonable grounds to conclude that the organization or foundation has made, makes, or will make available any of its resources, directly or indirectly, to an organization or

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<sup>111</sup> See, e.g., *Revenue Commissioners v. Oldham Training and Enterprise Council*, [1996] BTC 539 (Ch. D.) (regarding as charitable under the “relief of poverty” heading an organization the purpose of which was to provide services to the poor to enable them to become economically independent); and *Vancouver Society*, *supra* note 71 (rejecting earlier Canadian understandings of the “advancement of education” as “formal training of the mind” or the “improvement of a useful branch of human knowledge”).

<sup>112</sup> See, e.g., *Positive Action Against Pornography v. MNR*, [1988] 1 CTC 232, 88 DTC 7186 (F.C.A.); *Toronto Volograd Committee v. MNR*, [1988] 1 CTC 365, 88 DTC 6192 (F.C.A.); *Briarpatch Incorporated v. The Queen*, [1996] 2 CTC 94, 96 DTC 6294 (FCA); *Interfaith Development Education Association v MNR*, [1997] 3 CTC 271, 97 DTC 5424 (FCA); and *Alliance for Life v. MNR*, [1999] 3 CTC 1, 99 DTC 5228 (FCA). The CCRA has recently indicated that it is willing to expand its view of these categories to include organizations that might otherwise not qualify on the grounds that they are “political” in nature. See Consultation on Proposed Policy: “Registering Charities the Focus on Eliminating Racial Discrimination” available at [http://www.ccradrc.gc.ca/tax/charities/consultations/eliminating\\_discrimination-e.html](http://www.ccradrc.gc.ca/tax/charities/consultations/eliminating_discrimination-e.html).

<sup>113</sup> See, e.g., *Bowman v. Secular Society*, [1917] AC 406 (HL); *Regina v. Registrar-General, Ex Parte Segerdal*, [1970] 2 QB 697 (CA); and *Re South Place Ethical Society*, [1980] 1 WLR 1565 (Ch.). For a useful discussion of this category in the Canadian context, see Phillips, “Religion, Charity, and the Charter,” *supra* note 66.

<sup>114</sup> See, e.g., *Challenge Team v. Revenue Canada*, [2000] 2 CTC 352, 2000 DTC 6242 (F.C.A.).

person that has engaged in, engages in, or will engage in terrorism or activities in support of terrorism.<sup>115</sup>

## B. Qualifying Gifts

Also common to each of the tax incentives available for charitable contributions is the requirement that the donor have made a “gift” to the eligible recipient. In this circumstance ITA paragraphs 38(a.1) and (a.2) and subparagraph 39(1)(a)(i.1) exempt part of all of any gain on the disposition of publicly-traded securities, ecologically sensitive land or cultural property, while sections 110.1 and 118.1 permit the donor to claim a deduction or credit in respect of the “fair market value” of the gift. As a general rule, the words “fair market value” refer to “the highest price available estimated in terms of money which a willing seller may obtain for the property in an open and unrestricted market from a willing knowledgeable purchaser acting at arm's length.”<sup>116</sup> Although a number of reported

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<sup>115</sup> See paragraph 4(1)(a) of the *Charities Registration (Security Information) Act*, S.C. 2001, c. 41, s. 113. For a critical evaluation of this legislation, see David G. Duff, “Charitable Status and Terrorist Financing: Rethinking the Proposed *Charities Registration (Security Information) Act*” in Ronald J. Daniels, Patrick Macklem, and Kent Roach, *The Security of Freedom: Essays on Canada's Anti-Terrorism Bill*, (Toronto: University of Toronto Press, 2001) 321-37.

<sup>116</sup> *MNR v. Mann Estate*, [1972] 5 WWR 23 (B.C.S.C.), aff'd [1973] CTC 561, [1973] 4 W.W.R. 223 (B.C.C.A.), aff'd [1974] CTC 222, [1974] 2 WWR 574 (S.C.C.)

cases consider the fair market value of particular gifts,<sup>117</sup> the key interpretive issues for the purposes of this paper concern the characterization of a “gift” for these purposes and the kinds of contributions that can be the subject matter of such a gift.

In the absence of a statutory definition of the word “gift”, Canadian courts have looked to private law concepts in order to apply these provisions. In common law provinces, courts have defined a gift as “a voluntary transfer of property from one person to another gratuitously and not as the result of a contractual obligation without anticipation or expectation of material benefit.”<sup>118</sup> In Quebec, on the other hand, a gift is defined as a contract by which a person, the donor, transfers

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<sup>117</sup> Several of these cases involve so-called “art flips” in which taxpayers acquired property at one price and immediately thereafter donated the property to an eligible recipient at an appraised value significantly in excess of its purchase price, benefiting from the exemption on gifts of cultural property under ITA subparagraph 39(1)(a)(i.1) or the rule in paragraph 46(1)(a) deeming the adjusted cost base of “personal-use property” to be the greater of \$1,000 and the amount otherwise determined. See, e.g., *Friedberg v. The Queen*, [1992] 1 CTC 1, 92 DTC 6031 (F.C.A.) [hereafter *Friedberg*]; *Arvais v. MNR*, [1993] 1 CTC 2473, 93 DTC 506 (TCC); *Ball v. The Queen*, [1993] 2 CTC 2474 (T.C.C.); *Ball v. The Queen*, [1993] 2 CTC 2475 (T.C.C.); *Gardner v. The Queen*, [1993] 2 CTC 2480 (T.C.C.); *Bouchard v. The Queen*, [1993] 2 CTC 2778 (T.C.C.); *Paradis v. The Queen*, [1997] 2 CTC 2557 (T.C.C.); *Marcoux-Côté v. The Queen*, [2001] 4 CTC 54, 2000 DTC 6615 (F.C.A.); *Whent v. The Queen*, [2000] 1 CTC 329, 2000 DTC 6001 (FCA); *Aikman v. The Queen*, [2002] 2 CTC 147, 2002 DTC 6874 (F.C.A.); *Duguay v. The Queen*, [2002] 1 CTC 8, 2000 DTC 6620 (F.C.A.); and *Langlois v. The Queen*, 2000 DTC 6612 (F.C.A.); *Berubé v. Canada*, [2002] CTC 2147 (T.C.C.). In response to these kinds of transactions, ITA subsection 118.1(10) was enacted in 1990 to authorize the Canadian Cultural Property Export Review Board to determine the fair market value of gifts of cultural property, and subsection 46(5) was enacted in the year 2000 to exclude from the deemed adjusted cost base rule in paragraph 46(1)(a) “property acquired by the taxpayer, or a person with whom the taxpayer does not deal at arm’s length, in circumstances in which it is reasonable to conclude that the acquisition of the property relates to an arrangement, plan or scheme that is promoted by another person or partnership and under which it is reasonable to conclude that the property will be the subject of a gift to which subsection 110.1(1) or ... subsection 118.1(1) applies.”

ownership of property by gratuitous title to another person, the donee”.<sup>119</sup>

According to section 8.1 of the federal *Interpretation Act*<sup>120</sup>:

Both the common law and the civil law are equally authoritative and recognized sources of the law of property and civil rights in Canada and, unless otherwise provided by law, if in interpreting an enactment it is necessary to refer to a province’s rules, principles or concepts forming part of the law of property and civil rights, reference must be made to the rules, principles and concepts in force in the province at the time the enactment is being applied.

As a result, it follows, while the civil law concept of a gift applies in Quebec, the common law concept applies in the rest of Canada.<sup>121</sup>

To the extent that the common law concept requires a “voluntary transfer” for “no benefit or consideration”, while the civil law concept requires a “contract” to transfer ownership, therefore, the ITA appears to mandate different requirements for qualifying gifts in Quebec and the rest of the country. Indeed, while the courts in Quebec have recognized a binding legal contract of donation between a charity and a donor as a valid gift,<sup>122</sup> the status of such donations in

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<sup>118</sup> *Woolner v. The Queen*, [2000] 1 C.T.C. 35, 99 D.T.C. 5722 (F.C.A.) at para. 7. For similar definitions, see *The Queen v. Zandstra*, [1974] C.T.C. 503, 74 D.T.C. 6416 (F.C.T.D.) (hereinafter *Zandstra*) at paras. 19-22; *McBurney v. The Queen*, [1985] 2 C.T.C. 214, 85 D.T.C. 5433 (F.C.A.) (hereinafter *McBurney*) at para. 11-13; *Burns v. M.N.R.*, [1988] 1 C.T.C. 201, 88 D.T.C. 6101 (F.C.T.D.) (hereinafter *Burns*) at para. 24-26, aff’d [1990] 1 C.T.C. 350, 90 D.T.C. 6335 (F.C.A.); *Friedberg*, *supra* note 118 at para. 4; and *Whent v. The Queen*, [1996] 3 C.T.C. 2542, 96 D.T.C. 1594 (T.C.C.) at para. 37, aff’d [2000] 1 C.T.C. 329, 2000 D.T.C. 6001 (F.C.A.).

<sup>119</sup> See Article 1806 of the *Civil Code of Québec*, L.Q. 1991, c. 64. See also Article 1810, which states that: “A remunerative gift or a gift with a charge constitutes a gift only for the value in excess of that of the remunerative charge.”

<sup>120</sup> R.S.C. 1985, c. I-21.

<sup>121</sup> For a more detailed discussion of these issues, see David G. Duff, “The Federal *Income Tax Act* and Private Law in Canada: Complementarity, Dissociation, and Canadian Bijuralism” (2003), 51 *Can. Tax J.* (forthcoming). See also Blake Bromley, “Flaunting and Flouting the Law of Gift: Canada Customs and Revenue Agency’s Philanthrophobia” (2002), 21 *Estates, Trusts & Pensions Journal* 177.

<sup>122</sup> *Francoeur v. The Queen*, [1993] 2 CTC 2440 (TCC).

common law provinces is uncertain.<sup>123</sup> More significantly, while at least one Quebec decision has affirmed the existence of a gift where a donor purchased tickets for a benefit concert and reception at a price substantially in excess of their value,<sup>124</sup> other cases have generally disallowed deductions or credits for charitable contributions where the donor has received valuable consideration in exchange for the contribution<sup>125</sup> – even where the taxpayer has sold property to a charitable organization for proceeds less than its fair market value,<sup>126</sup> or purchased property from a charitable foundation for an amount exceeding its fair market value.<sup>127</sup>

Where the donor derives a tax advantage or other monetary benefit from the

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<sup>123</sup> According to the Canada Customs and Revenue Agency: “Generally, any legal obligation on the payor to make a donation would cause the donation to lose its status as a gift. However, when a taxpayer honours a personal guarantee concerning a loan made to a charity or honours a pledge, the amount can be considered to be a gift despite its being paid to honour an obligation, if the obligation was entered into voluntarily and without consideration.” Interpretation Bulletin IT-110R3, “Gifts and Official Donation Receipts” (June 20, 1997), para. 9.

<sup>124</sup> *Aspinall v. MNR*, [1970] Tax ABC 1073, 70 DTC 1669. For a similar result, see *Gagnon v. M.N.R.* (1960), 24 Tax A.B.C. 309, 60 D.T.C. 347, in which the difference between the fair market value of a farm sold by the taxpayer to his sons and the actually proceeds received was characterized as a gift for the purpose of the gift tax in then section 111 of the ITA. In two other cases, however, Quebec courts have adopted the common law concept of a gift for the purpose of other provisions in the ITA. See *The Queen v. Littler*, [1978] C.T.C. 235, 78 D.T.C. 6179 (F.C.A.) (refusing to apply gift tax to the sale of shares to the taxpayer’s son for an amount less than their fair market value on the basis that the civil law concept of a gift “should not be taken to extend the application of section 111 of the *Income Tax Act* in the Province of Quebec beyond what it would be in another province”); and *Gervais v. The Queen*, [1984] C.T.C. 661, 85 D.T.C. 5004 (F.C.T.D.) (concluding that property acquired by the taxpayer from his father at a cost less than its fair market value was not acquired by way of a gift).

<sup>125</sup> See, e.g., *Woolner, McBurney, and Zandstra*, *supra* note 119 (each of which involved gifts to religious schools attended by one or more of the donor’s children); *Burns*, *supra* note 119 (gifts to a ski association which conducted a ski camp attended by the donor’s daughter); *Dupriez v. The Queen*, [1999] 1 CTC 2227, 98 DTC 1790 (TCC) (gifts to a charitable organization which assisted donors in adopting children from Vietnam); and *Nadeau v. The Queen*, [2001] CarswellNat 3589 (T.C.C.) (donation to college in exchange for which taxpayer received a computer). For a contrasting result, see *Jubenville v. The Queen*, [2002] 4 C.T.C. 2058 (T.C.C.), in which the Court disallowed \$3,000 of a \$14,000 contribution to a Russian organization on the basis that it was required to adopt a child, but allowed the taxpayer to claim a charitable contributions tax credit for the remaining \$11,000.

<sup>126</sup> *Gaudin v. MNR* (1955), 13 Tax A.B.C. 199, 55 DTC 385 [hereafter *Gaudin*].

<sup>127</sup> *Tite v. MNR*, [1986] 2 CTC 2343, 86 DTC 1788 (TCC) [hereafter *Tite*].

contribution, however, courts have generally held that these benefits do not vitiate the existence of a gift.<sup>128</sup> As an administrative practice, moreover, the Canada Customs and Revenue Agency allows donors to claim as a qualifying gift “the difference between the purchase price of a ticket to attend a ‘dinner, ball, concert or show’ and the fair market value of the food, entertainment etc., available to a ticket purchaser”,<sup>129</sup> as well as “a part of a parent’s payment for instruction at a private elementary or secondary school which offers both secular (academic) and religious education” equal to the part “for the religious education only.”<sup>130</sup>

With respect to the kinds of contributions that can be the subject matter of a “gift”, an early case suggested that “gifts made in kind instead of cash are not deductible in practice on account of the problem of correct valuation.”<sup>131</sup> Notwithstanding this concern, a subsequent decision confirmed that donors may claim a deduction or credit for gifts of property in kind.<sup>132</sup> As an administrative practice, however, the Canada Customs and Revenue Agency does not recognize gifts-in-kind of nominal value, such as gifts of used clothing with little commercial

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<sup>128</sup> See, e.g., *Friedberg*, *supra* note 118 at 2 (CTC) (“The tax advantage which is received from gifts is not normally considered a ‘benefit’ within [the legal definition of a gift], for to do so would render the charitable donations deductions unavailable to many donors.”); and *Langlois v. The Queen*, [1998] 3 CTC 2589 (T.C.C.) at para. 115, *aff’d* [1999] 4 CTC 258, 99 DTC 5615 (F.C.A.) (“The fact that the donor was able to incidentally derive a monetary benefit from the transactions is of no consequence, since the donee paid no consideration.”). As a result, although some cases have suggested that a gift requires a “liberal intent” [*Burns*, *supra* note 119 at 6105 (DTC)] or a “detached and disinterested generosity” [*Tite*, *supra* note 128 at 1791 (DTC)], the prevailing view ignores these subjective factors.

<sup>129</sup> Interpretation Bulletin IT-110R3, *supra* note 124, para. 5.

<sup>130</sup> *Registered Charities Newsletter No. 6* (Summer 1996).

<sup>131</sup> *Gaudin*, *supra* note 127 at 386 (DTC).

<sup>132</sup> *Consolidated Truck Lines v. MNR*, [1968] Tax ABC, 68 DTC 399 (donation of a yacht to the University of Toronto).

value.<sup>133</sup> In addition, where an individual donates time and labour to a charitable organization or foundation, it has been held that the value of the donation is not a qualifying gift for the purposes of the deduction or credit on the basis that the legal meaning of a gift requires the transfer of “property” and services are not property.<sup>134</sup>

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<sup>133</sup> Interpretation Bulletin IT-297R2, “Gifts in Kind to Charity and Others” (March 21, 1990), para. 6.

<sup>134</sup> *Slobodrian v. The Queen*, [1998] 3 CTC 2654 (T.C.C.); *Slobodrian v. Canada*, [2002] 1 CTC 2089 (T.C.C.); and *Nasrallah c. Canada*, [2002] CarswellNet 1564, [2002] AC no. 346 (QL) (T.C.C.) See also Interpretation Bulletin IT-110R3, *supra* note 123, para. 15(d) (“A gift must involve property. Contributions of services (that is, time, skills, effort) are not property and do not qualify.”).

## C. Tax Benefit

Where a taxpayer makes a qualifying gift to an eligible recipient, the ITA provides three different kinds of tax benefit: a deduction for corporations, a credit for individuals, and full or partial exemption from capital gains on gifts of cultural property, publicly-traded securities, and ecologically sensitive land. This section examines each of these incentives.

### *1. Deduction for Corporations*

Where a corporation makes a charitable gift to an eligible recipient, the fair market value of the gift is deductible in computing the corporation's taxable income for the year or any of the five subsequent taxation years.<sup>135</sup> While the deduction contains no limit on gifts of cultural property and ecologically sensitive land,<sup>136</sup> the deduction for other gifts is generally subject to a ceiling of 75% of the donor's income for the year.<sup>137</sup> Where the corporation makes a gift of property resulting in a taxable capital gain or recaptured depreciation, a quarter of this inclusion may be added to the annual ceiling, effectively increasing the ceiling on these charitable gifts to the amount of the donor's income for the year.<sup>138</sup>

While the current provision was enacted only in 1988,<sup>139</sup> a deduction for corporate charitable contributions dates back to 1930, when the federal government introduced a deduction available to all taxpayers up to 10 percent of

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<sup>135</sup> ITA, subsection 110.1(1).

<sup>136</sup> ITA, paragraphs 110.1(1)(c) and (d).

<sup>137</sup> ITA, paragraph 110.1(1)(a).

<sup>138</sup> ITA, paragraph 110.1(1)(a).

<sup>139</sup> SC 1988, c. 55, s. 78.

their incomes for the year.<sup>140</sup> Although there does not appear to have been any justification for a corporate deduction at the time,<sup>141</sup> the Exchequer Court speculated on the deduction's purpose as follows in *Olympia Floor & Wall Tile (Que.) Ltd. v. MNR*<sup>142</sup>:

Presumably, a time came in the evolution of income tax law when, the more sophisticated campaigns of charitable organizations having resulted in corporations being forced to make charitable contributions (not because they were as corporations capable of charitable motivation but because an atmosphere was created in which a failure to contribute would damage the corporate "image" so as to affect adversely the corporation's business operations), Parliament, for that reason, decided that corporations should have some sort of tax treatment for such contributions as individuals.

While this account seems to suggest that corporate charitable contributions would be ordinarily deductible in computing the donor's net income from its business operations, the Court nonetheless distinguished the deduction for charitable contributions from a deduction for business expenses on the basis that the former permits "a deduction of an amount that has been given out of the corporation's income after it has been earned and not a deduction of an amount that has been laid out as part of the income earning process".<sup>143</sup> Since the Court allowed the taxpayer to deduct gifts to charitable organizations as ordinary business expenses on the basis that they were incurred for the purpose of gaining or producing income, moreover, it follows that the separate deduction for corporate

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<sup>140</sup> For a brief history of the introduction of this deduction, see Duff, "Charitable Contributions and the Personal Income Tax" *supra* note 5 at 408-09. The 10 percent ceiling on allowable deductions was reduced to 5 percent in 1940 and increased to 10 percent in 1957, 20 percent in 1972, 50 percent in 1996, and 75 percent for 1997 and subsequent taxation years.

<sup>141</sup> See *ibid.*

<sup>142</sup> *Supra* note 1, at para. 13.

charitable contributions should be understood not as a necessary adjustment to obtain an accurate measurement of its income for the year, but as a tax incentive or tax expenditure designed to provide further encouragement to corporate charitable giving irrespective of business considerations.<sup>144</sup>

As a tax expenditure, the deduction for corporate charitable contributions is estimated to have cost the federal government \$180 million in 1998.<sup>145</sup> As a general rule, the additional cost to provincial treasuries, which levy identical or similar corporate income taxes at approximately half the federal rates, is roughly half the amount of the federal expenditure. Statistics are unavailable on the distribution of corporate donations among different kinds of registered charities or the distribution of this expenditure among different corporations. Since corporations are generally taxable at a flat rate, one might conclude that the distribution of the tax expenditure among different corporations gives rise to no concerns about tax equity. Nonetheless, since federal and provincial corporate income tax rates vary by the kind of income earned, with lower rates for “manufacturing and processing” income and for the first \$300,000 of “active

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<sup>143</sup> *Ibid.*

<sup>144</sup> In this respect, the scheme of the ITA assumes a “social responsibility” view of the corporation, rather than a “profit maximizing” approach. For an illuminating discussion of these issues in the U.S. context, see Nancy J. Knauer, “The Paradox of Corporate Giving: Tax Expenditures, The Nature of the Corporation, and the Social Construction of Charity” (1994), 44 *DePaul L. Rev.* 1 (advocating repeal of a separate deduction for corporate charitable contributions and the deduction of these gifts as ordinary business expenses).

<sup>145</sup> Department of Finance, *Tax Expenditures and Evaluations*, *supra* note 65, Table 2. This amount includes deductions for “charitable gifts” proper, as well as gifts to the federal government or a province. According to the Department of Finance, the cost of this tax expenditure is projected to increase to \$200 million in 1999 and \$250 million in the year 2000, after which it is expected to fall to \$215 million in 2001 and \$165 million in 2002, due to decreases in the general corporate tax rate and reductions in projected taxable income.

business income” earned by a “Canadian-controlled private corporation”, the corporate charitable contributions deduction provides a different level of tax assistance for donations from different corporate entities. More significantly, where the donor corporation incurs a loss, the value of the deduction is nil, since there is no income against which the fair market value of a gift may be deducted.

## *2. Individual Credit*

Unlike charitable contributions by corporations, charitable contributions by individuals are recognized in the form of a tax credit rather than a deduction. At the federal level, this credit is computed at the lowest marginal rate of tax for the first \$200 of total gifts claimed in the taxation year and the highest marginal rate for amounts exceeding \$200.<sup>146</sup> For the year 2002, the federal rate structure implies a credit of 16 percent on the first \$200 claimed each year and 29 percent on amounts over \$200.<sup>147</sup> Most provinces adopt a similar two-tiered rate structure for their credits, which generally range from 6.05 to 11.25 percent on the first \$200 and 14.07 to 18.02 percent on amounts above this threshold.<sup>148</sup> As a general rule, therefore, the combined federal and provincial rates for this credit are

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<sup>146</sup> ITA, subsection 118.1(3).

<sup>147</sup> See ITA subsection 117(2), as indexed by section 117.1, which defines basic federal tax payable as 16% of taxable income up to \$31,677, 22% of taxable income between \$31,678 and \$63,354, 26% of taxable income between \$63,355 and \$103,000, and 29% of taxable income exceeding \$103,000.

<sup>148</sup> In Alberta, which introduced a flat-rate income tax of 10% effective for 2001 and subsequent taxation years, the credit is computed at 10% for the first \$200 and 12.75% on amounts over \$200. In Quebec, the credit is computed at a rate of 20% on the first \$2,000 claimed in the year, and 24% on amounts exceeding \$2,000.

approximately 25 percent up to \$200 and 45 percent above this amount.<sup>149</sup> Since the credits are non-refundable and non-transferable, however, they are worthless to individual donors whose incomes are too low to pay any tax. As an administrative practice, however, the Canada Customs and Revenue Agency allows an individual to claim charitable donations made by the individual's spouse or common-law partner and dependants, regardless of who actually made the gift.

Like the corporate deduction, the individual credit allows taxpayers to claim the fair market value of gifts that were made during the year or any of the five preceding taxation years.<sup>150</sup> Also like the corporate deduction, the aggregate value of gifts that may be claimed in the year is subject to a limit of 75% of the donor's income for the year, except for gifts of cultural property or ecologically sensitive land, or where the gift results in a taxable capital gain or recaptured depreciation.<sup>151</sup> Where an individual dies, however, the ceiling is increased to the individual's income for the year and the year before death,<sup>152</sup> and gifts that cannot be claimed in the year of the individual's death may be carried back to be claimed in the taxation year before the individual's death.<sup>153</sup>

The non-refundable credit was introduced in 1988, at which time the federal government repealed a general deduction for charitable contributions that

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<sup>149</sup> The exceptions are Alberta where the combined rate on amounts exceeding \$200 is 41.75%, and Quebec where combined rates are 36% on amounts up to \$200, 49% on amounts between \$200 and \$2,000, and 53% on annual contributions exceeding this amount.

<sup>150</sup> ITA, subsection 118.1(1).

<sup>151</sup> *Ibid.*

<sup>152</sup> See paragraph (a)(ii) of the definition of "total gifts" in ITA, subsection 118.1(1).

<sup>153</sup> ITA, subsection 118.1(4).

was first enacted in 1930.<sup>154</sup> By providing a larger tax benefit to high-income taxpayers than low-income taxpayers, critics had argued that a deduction was a regressive way to encourage charitable donations, which provided a larger tax subsidy to charities favoured by high-income donors than it did to charities preferred by low-income donors.<sup>155</sup> Although acknowledging that equity would favour “a system of credits for charitable donations” so that “[t]he tax concession would ... be related only to the size of the donation and would not also depend upon the income of the taxpayer,”<sup>156</sup> the Canadian Royal Commission on Taxation (Carter Commission) recommended that the deduction “should be continued” on the grounds that a credit would “tend to stifle charitable giving by upper income individuals and families.”<sup>157</sup>

While the Carter Commission did not explain why a reduction in charitable giving by “upper income individuals and families” justified an admittedly inequitable deduction, two arguments might be made. First, if the price elasticity of charitable giving increases with income, as some studies have suggested,<sup>158</sup> a deduction for charitable donations would be more efficient than a flat-rate credit – encouraging more charitable gifts than a credit costing the same amount in terms of

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<sup>154</sup> For a brief history of the introduction of this deduction, see Duff, “Charitable Contributions and the Personal Income Tax” *supra* note 5 at 408-09.

<sup>155</sup> See, e.g. Thirsk, “Giving Credit Where Credit is Due,” *supra* note 10 at 37 (“Under the present system, the price of charitable donations is significantly cheaper if made by a wealthy donor rather than a poor one. Consequently, the charities favoured by the rich receive greater encouragement than those patronized by the poor.”).

<sup>156</sup> *Report of the Royal Commission on Taxation*, *supra* note 33 at 222.

<sup>157</sup> *Ibid.* This argument necessarily assumes that the rate or rates for the credit would be less than the top marginal rate.

foregone revenue.<sup>159</sup> Second, if the kinds of charities that high-income donors tend to prefer (hospitals, universities, and cultural institutions) produce greater social benefits than the charities favoured by low-income taxpayers (churches and religious organizations), a deduction would provide a larger indirect subsidy to “more worthy” organizations than a revenue-neutral flat-rate credit.<sup>160</sup> In response, however, critics of a deduction could point to studies challenging the assumption that the price elasticity of charitable giving increases with income,<sup>161</sup> question whether the kinds of charities favoured by high-income donors do in fact provide

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<sup>158</sup> See, e.g., Henry Aaron, “Federal Encouragement of Private Giving,” in *Tax Impacts on Philanthropy*, Symposium conducted by the Tax Institute of America (Princeton: Tax Institute of America, 1972) 211.

<sup>159</sup> See, e.g., Graham Glenday, Anil K. Gupta, and Henry Pawlak, “Tax Incentives for Personal Charitable Contributions” (1986), 68 *Rev. Econ. & Stats.* 688 at 692 (estimating that a revenue-neutral tax credit of 29 percent would cause aggregate donations to fall by \$10 million, while a high-rate credit of 50 percent would increase aggregate donations by only \$6 million at a cost in terms of foregone revenue of \$422 million).

<sup>160</sup> See, e.g., Faye Woodman, “The Tax Treatment of Charities and Charitable Donations Since the Carter Commission: Past Reforms and Present Problems” (1988), 26 *Osgoode Hall L.J.* 537 at 575 (“Simply, an argument may be made that some institutions are richer contributors to the social, cultural, and intellectual mosaic than others. Hence, it may be possible to justify a system of deduction that is skewed in the direction of the favourite charities of upper-income taxpayers.”). For studies suggesting that high-income donors tend to give more to hospitals, universities, and cultural institutions, while low-income donors favour churches and religious organizations, see Taussig, “Economic Aspects,” *supra* note 38; Martin Feldstein, “The Income Tax and Charitable Contributions: Part II - The Impact on Religious, Educational and Other Organizations” (1975), 28 *Nat. Tax J.* 209; and Kitchen and Dalton, “Determinants of Charitable Donations by Families in Canada” *supra* note 51. For a “somewhat less elitist” version of this argument, see Simon, *supra* note 63 at 69 (suggesting that “whether or not wealthy givers are better suited to uphold cultural and intellectual standards, affluent individuals are more likely to be idiosyncratic or unorthodox” and contending that this “idiosyncrasy and heterodoxy” might “justify ... the inegalitarian charitable deduction in the name of pluralism”).

<sup>161</sup> See, e.g., Michael J. Boskin and Martin Feldstein, “Effects of Charitable Deductions on Contributions by Low Income and Middle Income Households: Evidence from the National Survey of Philanthropy” (1978), 59 *Rev. Econ. & Stats.* 351; and Yong S. Choe and Jinook Jeong, “Charitable Contributions by Low- and Middle-Income Taxpayers: Further Evidence with a New Method” (1993), 66 *Nat. Tax J.* 33.

more public benefits than the kinds of charities preferred by low-income donors,<sup>162</sup> and contend that any decision to favour donations to some charities over donations to others should be explicit, not obscured in the form of a deduction.<sup>163</sup>

Weighing the pros and cons of deductions and credits, the federal government opted to repeal the deduction for individual charitable contributions effective for 1988 and subsequent taxation years, introducing in its place a credit which would “increase fairness by basing tax assistance on the amount given, regardless of the income level of the donor.”<sup>164</sup> In order to “maintain a substantial incentive for charitable giving”<sup>165</sup> without significantly increasing the cost of the incentive in terms of foregone revenues, however, the credit was set at the lowest marginal rate of tax on charitable donations claimed up to \$250, and the highest marginal rate of tax on amounts exceeding this threshold. In 1994, the \$250 threshold was lowered to \$200.<sup>166</sup>

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<sup>162</sup> See, e.g., Scharf, Cherniavsky and Hogg, *Tax Incentives for Charities in Canada*, *supra* note 39 at 28 (“Available evidence ... seems to suggest that the activities of the nonprofit organizations and charities typically supported by the rich do not produce higher valued externalities than do those supported by lower income earners. In fact, the converse may be true: universities and cultural organizations are charities that may be viewed as more “local” than churches and religious organizations. Thus larger giving by high income earners should be discouraged on efficiency grounds, while smaller gifts by low income earners should be encouraged.”); and Duff, “Charitable Contributions and the Personal Income Tax” *supra* note 5 at 435 (“In a pluralistic society, ... who is to say that the public benefits associated with religious activities are any less than those associated with higher education.?”).

<sup>163</sup> See, e.g., Wolkoff, “Proposal for a Radical Alternative,” *supra* note 50 at 291 (“if some institutions are to be favored over others, the decision should be made democratically”); and Brooks, *Financing the Voluntary Sector*, *supra* note 28 at 26 (“If certain activities are to be favoured over others, that choice should be clearly reflected on the face of the instrument chosen.”).

<sup>164</sup> Hon. Michael Wilson, *Tax Reform 1987: White Paper*, (Ottawa: Minister of Supply and Services, 1987) at 32.

<sup>165</sup> *Ibid.*

<sup>166</sup> SC 1995, c. 3, s. 34.

Although promoted as a fairer incentive for charitable contributions, which would provide an “equal reward for effort in giving by donors in all income brackets in contrast to the ... deduction system which provides greater reward for those in higher income brackets,”<sup>167</sup> empirical analysis suggests that it continues to provide a greater tax benefit to donors with higher incomes than to low-income donors. As Table 1 illustrates, since average contributions by low-income taxpayers are either less than or not much greater than the \$200 threshold, while average contributions by high-income taxpayers greatly exceed the \$200 threshold, a significant proportion of charitable donations by low-income taxpayers are creditable at the lowest marginal rate, whereas most charitable contributions by high-income taxpayers are creditable at the highest marginal rate.

In 1999, for example, the average rate of the credit for charitable contributions was 23.6 percent for donors with incomes less than \$10,000, 26 percent for donors with incomes between \$10,000 and \$30,000, 26.7 percent for donors with incomes between \$30,000 and \$60,000, 27.2 percent for donors with incomes between \$60,000 and \$100,000, 28.3 percent for donors with incomes between \$100,000 and \$250,000, and 28.8 percent for donors with incomes exceeding \$250,000. Since the credit is not refundable, moreover, it provides no support for charitable giving by taxpayers whose income is too low to pay any tax.

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<sup>167</sup> Department of Finance, *Supplementary Information Relating to Tax Reform Measures*, (Ottawa: the department, 1987) at 10.

As a result, as one commentator has suggested, the two-tier credit is properly regarded as “a deduction masquerading as a credit.”<sup>168</sup>

Table 1  
Average Federal Charitable Tax Credit Rates by Income Class  
(1999)

Income Class (\$)	Average Donation for Taxfilers Claiming Donations <sup>169</sup> (\$)	Average Federal Charitable Tax Credit <sup>170</sup> (\$)	Average Federal Charitable Tax Credit Rate <sup>171</sup> (%)
Loss or Nil	0	0	0
1 – 10,000	218	51	23.6
10,000 - 30,000	520	135	26.0
30,000 - 60,000	680	182	26.7
60,000 - 100,000	1,200	327	27.2
100,000 - 250,000	2,300	646	28.3
Over 250,000	14,670	4,232	28.8

Source: Calculated from figures in Canada Customs and Revenue Agency, *Income Statistics 2001: 1999 Tax Year*, available at <http://www.ccr-adrc.gc.ca/tax/individuals/stats/gb99/pst/interim/pdf/table2-e.pdf>

Moreover, as Table 2 illustrates, since taxpayers with higher incomes are both more likely to make charitable gifts than low-income taxpayers and able to make larger donations, the credit provides a much larger indirect subsidy to charities favoured by high-income taxpayers than it does to charities selected by low-income taxpayers. In 1999, for example, the 21.7 percent of taxfilers with incomes between \$10,000 and \$30,000 received only 0.5 percent of aggregate

<sup>168</sup> Bromley, “Charity, Philanthropy and Stewardship,” *supra* note 35 at 5.

<sup>169</sup> Calculated as the aggregate of charitable donations, government gifts, cultural gifts and ecological gifts reported by taxfilers in the income category, divided by the number of taxfilers in the income category claiming the charitable donations credit.

<sup>170</sup> Calculated as the aggregate value of tax credits received by taxfilers in the income category divided by the number of taxfilers in the income category claiming the charitable donations credit.

charitable tax credits claimed, while the 0.4 percent of taxfilers with incomes exceeding \$250,000 received almost 20 percent of these credits. As the tax expenditure resulting from the individual charitable donations credit was estimated as \$1.35 billion in 1999,<sup>172</sup> these figures suggest that taxpayers reporting incomes over \$250,000 in that year obtained an aggregate tax benefit from the charitable contributions credit of approximately \$260 million.

**Table 2**  
**Distribution by Income Class of Tax-Filers, Charitable Donations Claimed, and Tax Credits (1999)**

Income Class (\$)	Percentage of Taxfilers	Percentage of Taxfilers in Class Claiming Charitable Contributions	Percentage of Aggregate Charitable Tax Credits Claimed
Loss or Nil	3.8	0	0
1 – 10,000	21.7	2.6	0.5
10,000 - 30,000	39.6	20.9	18.1
30,000 - 60,000	25.8	39.7	30.1
60,000 - 100,000	6.7	51.1	18.1
100,000 – 250,000	1.9	68.4	13.6
Over 250,000	0.4	74.3	19.6

Source: Calculated from figures in Canada Customs and Revenue Agency, *Income Statistics 2001: 1999 Tax Year*, available at <http://www.ccr-adrc.gc.ca/tax/individuals/stats/gb99/pst/interim/pdf/table2-e.pdf>.

<sup>171</sup> Calculated as the aggregate value of tax credits received by taxfilers in the income category divided by the aggregate value charitable donations, government gifts, cultural gifts and ecological gifts reported by taxfilers in the income category.

<sup>172</sup> Department of Finance, *Tax Expenditures and Evaluations 2002*, *supra* note 65, Table 1. This figure is projected to remain the same in the year 2000, to decrease to \$1.335 billion in the year 2001, and to increase thereafter to \$1.36 billion in 2002, \$1.385 billion in 2003, and \$1.41 billion in 2003.

### *3. Capital Gains Exemptions for Gifts of Appreciated Property*

Where an individual or corporation makes a gift of property that has appreciated in value, the taxpayer is deemed to have disposed of the property for proceeds equal to its fair market value, thereby triggering tax on the accrued gain.<sup>173</sup> Where the property is capital property, held for investment purposes or personal use, only half the gain is included in computing the taxpayer's income,<sup>174</sup> reducing the effective tax rate on these gains to half the rate otherwise applicable. Where the capital property is qualifying cultural property, however, the ITA exempts any capital gain on the disposition of the property to a designated institution or public authority, irrespective of whether the property is disposed of by way of a gift or a sale.<sup>175</sup> Where the capital property is a publicly-traded security that is donated to an qualified donee other than a private foundation or ecologically sensitive land that is donated to the federal government or a province or to a registered charity other than a private foundation "one of the main purposes of which is ... the conservation and protection of Canada's heritage", the ITA reduces the percentage of the gain included in computing the taxpayer's income from one-half to one-quarter.<sup>176</sup>

The incentive for gifts or sales of cultural property was enacted in 1977,<sup>177</sup> and is designed to facilitate the preservation of these cultural properties in Canada

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<sup>173</sup> See ITA, paragraph 69(1)(b) which applies to gifts *inter vivos*, and subsection 70(5) which applies to capital property transferred at death.

<sup>174</sup> ITA, section 38.

<sup>175</sup> ITA, subparagraph 39(1)(a)(i.1).

<sup>176</sup> ITA, paragraphs 38(a.1) and (a.2).

by encouraging their transfer to institutions or public authorities designated under the *Cultural Property Export and Import Act*.<sup>178</sup> According to subsection 11(1) of this statute, qualifying cultural property includes: (1) objects “of outstanding significance” by reason of their “close association with Canadian history or national life,” their “aesthetic qualities,” or their “value in the study of the arts or sciences”; and (2) objects “of such a degree of national importance” that their “loss to Canada would significantly diminish the national heritage.” The determination that a property is qualifying cultural property is made by the Canadian Cultural Property Export Review Board, established under the authority of the same statute.<sup>179</sup> The tax expenditure resulting from this incentive was estimated as \$11 million in 1998 and \$16 million in 1999.<sup>180</sup>

The incentive for gifts of ecologically sensitive land was introduced in the year 2000,<sup>181</sup> and is designed to further “[t]he protection of Canada’s natural heritage, and especially its species at risk” by “providing assistance to encourage Canadians to take voluntary action to protect species and to make responsible stewardship an easy choice.”<sup>182</sup> Like the exemption for transfers of cultural property, therefore, this incentive reflects a policy decision that gifts of this kind are of sufficient national importance that they merit a larger measure of tax

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<sup>177</sup> S.C. 1974-75-76, c. 50, s. 48, proclaimed in force from 6 September 1977.

<sup>178</sup> R.S.C. 1985, c. C-51.

<sup>179</sup> *Ibid.*, section 18.

<sup>180</sup> Department of Finance, *Tax Expenditures and Evaluations 2002*, *supra* note 65, Table 1. The estimated cost of this provision was projected to drop to \$14 million for 2000 and \$10 million thereafter.

<sup>181</sup> S.C. 2000, c. 17, s. 22(3).

assistance. Because the provision was introduced only recently, estimates of the resulting tax expenditure are not currently available.<sup>183</sup>

The incentive for gifts of publicly-traded securities was introduced in 1997, and originally applied only to gifts made after February 18, 1997 and before 2002.<sup>184</sup> According to supplementary information released with the 1997 Federal Budget, this provision was enacted in order to “facilitate the transfer of appreciated capital property to charities to help them respond to the needs of Canadians.”<sup>185</sup> In a special release issued on October 12, 2001, the Finance Minister announced that the incentive was “an effective additional incentive for people to make donations to charities,” and would be made permanent.<sup>186</sup> As a result, while the incentives for cultural property and ecologically sensitive land are intended to provide a larger tax subsidy for gifts producing a greater public benefit, the incentive for gifts of publicly traded securities is merely intended to increase aggregate donations irrespective of the charitable activities which these donations support. Assuming that donations of capital property are more responsive to the after-tax cost of

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<sup>182</sup> Department of Finance, *Tax Measures: Supplementary Information*, (Ottawa: the department, 2000).

<sup>183</sup> In its most recent tax expenditure analysis, however, the Department of Finance includes the cost of this measure together with its estimate for the cost of the reduced inclusion rate for donations of publicly-traded shares. For 2001 and subsequent taxation years, the combined cost of these tax expenditures is estimated at \$12 million. Department of Finance, *Tax Expenditures and Evaluations 2002*, *supra* note 65, Table 1.

<sup>184</sup> S.C. 1998, c. 19, s. 6.

<sup>185</sup> Department of Finance, *Tax Measures: Supplementary Information*, (Ottawa: the department, 1997).

<sup>186</sup> Department of Finance News Release, *Special Federal Tax Assistance for Charitable Donations of Publicly Traded Securities Made Permanent*, (October 12, 2001).

charitable giving than contributions out of annual income,<sup>187</sup> this measure might be expected to increase aggregate charitable donations at less cost in terms of foregone revenue than other tax incentives such as an increase in the rate of the credit. Although it is difficult to determine whether this incentive has increased aggregate donations, or merely induced donors to substitute gifts of publicly-traded securities for other gifts, data assembled by the federal Department of Finance indicate that the number of donors claiming this partial exemption increased from roughly 500 in 1997 to 2,400 in the year 2000, and that aggregate gifts of publicly-traded securities increased from \$69.1 million in 1997 to \$200.3 million in the year 2000.<sup>188</sup> The tax expenditure resulting from this incentive was estimated as \$6 million in 1997 and 1998 and \$13 million in 1999, and projected to increase to \$15 million in the year 2000, decreasing thereafter to \$12 million from 2001 to 2004.<sup>189</sup>

However effective these additional tax incentives may be as methods of either encouraging charitable donations or subsidizing gifts with substantial public benefits, there are two reasons to question the design of these incentives as full or

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<sup>187</sup> See Duff, “Charitable Contributions and the Personal Income Tax” *supra* note 5 at 432 (noting that “empirical studies do not appear to have confirmed the result”).

<sup>188</sup> Department of Finance, *Tax Expenditures and Evaluations 2002*, *supra* note 65, Part 2 (“Special Federal Tax Assistance for Charitable Donations of Publicly Traded Securities”) at 64. According to this study, donations of publicly traded securities were disproportionately made to large charities and to educational institutions. The latter conclusion is consistent with empirical studies indicating that affluent donors are more likely to make charitable gifts to educational institutions.

<sup>189</sup> *Ibid.*, Table 1. For 2000 and subsequent taxation years, estimates include both the tax expenditure for gifts of publicly-traded securities and the incentive for donations of ecologically-sensitive land. See *supra* note 184. These estimates reflect only the cost of the lower inclusion rate, not the further cost associated with the charitable contributions credit itself. Estimates of the associated cost of the charitable contributions credit appear in the “Special Federal Tax Assistance for Charitable Donations of Publicly Traded Securities”, *supra* note 190 at 68.

partial exemptions from capital gains tax otherwise payable on gifts of appreciated property. First, as William Andrews has observed, the additional “subsidy or artificial inducement” to charitable giving from this approach is both arbitrary and inequitable:

The magnitude of the subsidy is a function of the amount of unrealized appreciation in relation to the basis of the property and the taxpayer’s rates of tax, being the greatest for taxpayers in highest brackets and with the most appreciation.<sup>190</sup>

Second, as Richard Goode explains, this approach “tempts some donors to place excessive values on their gifts, occasionally with the collusion of recipient institutions.”<sup>191</sup> Although the incentive for publicly-traded securities appears to avoid this objection, since the fair market value of these securities is readily determinable, the incentive for gifts of cultural property was notoriously susceptible to this abuse until the enactment of ITA subsection 118.1(10) in 1990 authorizing the Canadian Cultural Property Export Review Board to determine the fair market value of gifts of cultural property.<sup>192</sup> In order to prevent this kind of abuse with gifts of ecologically sensitive land, the ITA requires the Minister of the Environment to determine the fair market value of these gifts.<sup>193</sup>

Finally, a further concern with the incentive for publicly-traded securities concerns the affect on philanthropic pluralism produced by an incentive the main beneficiaries of which are almost certain to be among the most affluent donors to

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<sup>190</sup> Andrews, “Personal Deductions in an Ideal Income Tax,” *supra* note 14 at 372. For a similar critique, see Rabin, *supra* note 23 at 926.

<sup>191</sup> Goode, *The Individual Income Tax*, *supra* note 10 at 167.

<sup>192</sup> See the discussion at note 118, *supra*.

<sup>193</sup> ITA, subsection 118.1(12).

charitable organizations and foundations. Although the Department of Finance does not appear to have collected data on the distribution of this tax incentive by income group,<sup>194</sup> data on the distribution by income class of charitable donations claimed in 1996 and 2000 are suggestive. As Table 3 illustrates, while the percentage of aggregate charitable contributions claimed by donors with incomes exceeding \$250,000 was 11.4 percent in 1996, before the incentive was introduced, this proportion increased to 21.0 percent in the year 2000, the year before the incentive was made permanent. In addition, since the value of the incentive increases as the donor's income increases, the effect of the incentive is to provide a larger indirect subsidy to the kinds of charities favoured by high-income donors. Indeed, educational institutions appear to have been major beneficiaries of this incentive.<sup>195</sup>

**Table 3**  
**Distribution of Taxfilers and Charitable Donations Claimed by Income Class**  
**(1996, 2000)**

Income Class (\$)	Percentage of Taxfilers (1996)	Percentage of Charitable Donations Claimed (1996)	Percentage of Taxfilers (2000)	Percentage of Charitable Donations Claimed (2000)
Loss and Nil	4.2	0	3.6	0
1 – 10,000	23.1	0.8	20.7	0.4
10,000 – 30,000	40.9	23.7	38.8	18.2
30,000 – 60,000	24.5	35.6	26.0	29.6
60,000 – 100,000	5.7	17.3	8.2	17.6
100,000 – 250,000	1.4	11.1	2.2	13.5
over 250,000	0.3	11.4	0.5	21.0

<sup>194</sup> This information was provided by Bill Murphy, Personal Income Tax Division, Department of Finance, in a telephone conversation on October 17, 2001.

<sup>195</sup> See *supra* note 190.

Source: Calculated from figures in Canada Customs and Revenue Agency, *Taxation Statistics on Individuals: 1996 Tax Year*, (Ottawa: Minister of Supply and Services, 1998); and Canada Customs and Revenue Agency, *Income Statistics 2002: 2000 Tax Year*, available at <http://www.ccr-adrc.gc.ca/tax/individuals/stats/gb00/pst/interim/pdf/table2-e.pdf>.

## IV. Reform

Specific recommendations for reforms to the current statutory scheme governing the tax treatment of charitable contributions in Canada can be divided into recommendations regarding the kinds of recipients donations to which should qualify for a tax incentive, recommendations regarding the kinds of contributions for which the incentive should be available, and recommendations with respect to the structure of the tax benefit provided to indirectly subsidize eligible recipients by encouraging qualifying contributions. This Part outlines the main conclusions arising from the above analysis.

### A. Eligible Recipients

Judicial decisions demonstrate an unwillingness on the part of the Canadian courts to expand the concept of charitable purposes and activities beyond the traditional categories acknowledged by the common law of charitable trusts. While the fourth *Pemsel* category of “other purposes beneficial to the community” might have permitted such an expansion, the Supreme Court of Canada’s incremental approach in the *Vancouver Society* case appears to have foreclosed this possibility. To the extent that a tax incentive for charitable contributions is intended to provide an indirect subsidy to non-governmental organizations providing goods and services of public benefit, this outcome is unfortunate. For this and other reasons, including the administrative uncertainty involved in determining charitable

status under the common law definition, it would be desirable to adopt a statutory definition of charitable purposes and activities.

While such a definition might build upon the *Pemsel* categories or the list of charitable activities mentioned in the *Statute of Elizabeth*, it should expand upon these sources in two significant ways. First, since the provision of public benefits is the rationale for the tax incentive, the statutory definition should make the concept of a public benefit the touchstone for eligibility. Second, to the extent that social and cultural pluralism is itself regarded as a public benefit, the statutory concept should reject the political purposes doctrine and the common law concept of religion, recognizing a public benefit in the advancement of alternative belief systems, both spiritual and ideological, provided that these do not contradict the values of a free and democratic society.

## **B. Qualifying Contributions**

Since the purpose of the tax incentive is to provide an indirect subsidy to non-governmental organizations providing goods and services of public benefit, contributions to eligible recipients should qualify for tax assistance whenever they confer an economic benefit on the recipient regardless of the motivations of the contributor. From this perspective, the key criterion is neither the voluntariness of the transfer nor the existence of any consideration in return, but the difference between the value of the contribution and the value of any consideration received in return. While the civil law meaning of a “gift” is compatible with this approach, the common law concept is needlessly restrictive.

For this reason, and because the ITA should ensure uniform treatment for charitable contributions in all Canadian provinces, it would be desirable to adopt a statutory definition of a “qualifying contribution” based on the economic substance of a transaction to confer an economic benefit on the recipient, rather than the legal form of the contribution as a “gift” under civil or common law. Since the incentive is intended to subsidize the provision of public benefits by non-governmental organizations, moreover, the concept of a qualifying contribution should apply to contributions of services as well as property.

### **C. Tax Benefit**

A tax incentive for charitable contributions is a pluralistic means of subsidizing charitable organizations, which enables donors to direct public subsidies to activities of their choosing by “voting” with their contributions. From this perspective, it would be inequitable to weigh these votes differently according to any characteristic personal to the donor such as the donor’s level of income, and inappropriate in most circumstances to bias this choice by providing larger incentives for contributions to some activities than others. Where a decision is made to favour some activities over others, however, this differentiation should be transparent and equally available to all potential donors. To the extent that the incentive is intended to promote social and cultural pluralism, moreover, it should limit the extent to which any one donor can direct public funds and place a greater emphasis on the number of donors than the size of their donations.

From this perspective, there are several flaws with the structure of the tax benefits for charitable contributions provided by the ITA. First, although the value of the individual tax credit does not explicitly vary with the donor's income, the two-tier structure functions much like a deduction, providing a larger amount of tax assistance to charitable contributions by high-income donors who are able to make larger donations than it does to low-income donors who cannot afford to contribute as much, and providing no assistance to donors whose incomes are too low to pay any tax. The additional incentives for gifts of cultural property, publicly-traded shares and ecologically sensitive land are even more inequitable, since the amount of the tax benefit depends not only on the donor's income but also on whether the donor happens to hold qualifying property that has appreciated in value. Nor is the deduction for corporate donations any better, since the amount of the tax benefit varies according to the kind and amount of income earned. For each of these incentives, therefore, the current rules weigh donors' votes differently, favouring contributions by larger and more profitable corporations and by high-income individuals. Nor do the current rules do much to moderate inequalities in the number of votes that donors can exercise in order to direct public funds, since annual limits on allowable contributions have risen over the years to 75 percent of the donor's income or more, and contributions that are made for the purpose of producing income are fully deductible without any limit.

Instead, equity and pluralism would be better served by disallowing deductions for charitable contributions made for the purpose of earning income, repealing the deduction for corporate donations, making the individual tax credit a

refundable credit with declining rates based on the amount claimed in the year, replacing the special incentives for gifts of cultural property and ecologically sensitive land with a higher-rate refundable credit for these kinds of gifts, and repealing the partial exemption for gifts of publicly-traded securities.