

# Submission on Incentives for Charitable Giving

Submitted To:

The Standing Committee on Finance  
Sixth Floor, 131 Queen Street  
House of Commons  
Ottawa ON K1A 0A6  
Canada

Submitted By:

Arthur B. C Drache C.M., Q.C., LL.B.

and

Adam Aptowitzer LL.B.

Drache Aptowitzer LLP  
226 MacLaren St.  
Ottawa, Ontario  
K2P 0L6

Phone: 613.237.3300

Fax: 613.237.2786

E: adamapt@drache.ca

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Standing Committee on Finance  
Sixth Floor,  
131 Queen St.  
Ottawa, ON  
K1A 0A6

Via Email: *fin@parl.gc.ca*

To the Standing Committee on Finance,

**Re: Submission on Tax Incentives for Charitable Giving**

**Executive Summary**

The broad line of enquiry the committee has adopted regarding the regulation of charities is an integral part of the committee's mandate to examine incentives to charitable giving as without trust in the sector few incentives are likely to be effective. In our submission the following changes should be made to enhance public trust in the system and improve the tax incentives for charitable donations.

- 1) As the Provinces are the only level of government with constitutional jurisdiction to regulate charities they must be included in the regulation of charities. This can effectively be done by forming a joint Federal – Provincial charity regulator. Such an entity would also have the ability to regulate other aspects of charity operations such as political advocacy and fundraising costs.
- 2) Motivating donors to give requires modernizing the definition of charity to create charities which meet modern needs. We submit that Parliament should legislate a definition of charity.
- 3) We propose three amendments to the income tax system:
  - a) Donation Tax Credits earned in the first 60 days of the calendar year should be available for carry back to the previous taxation year. This would allow donors to make decisions when completely informed of their tax situation for the previous year. It would also allow charities and donors to focus on the tax aspects of giving and increase the opportunities for educating taxpayers on the tax incentive of donating.

- b) The current limit on the use of donation tax credits (of up to 75% of taxable income) is both outdated and strictly a disincentive to giving. We submit that it should be removed.
- c) The dichotomous system which leads to a different tax credit on the first \$200 of giving than on the rest should be eliminated. And the entire amount should be credited at the highest marginal tax rate. This will simplify tax administration and will not tax individuals on income donated to charity.

**Incentives Generally**

Our understanding is that the committee is concerned with charitable donation incentives, foreign funding of charities, advocacy rules for charities and transparency. To some degree we believe all of these concerns can be addressed concurrently.

**Trust in the Sector as an Incentive to Giving**

Constitutionally, the jurisdiction to govern charities lies with the Provinces. However, for mostly historical reasons, the Provinces have abdicated their jurisdiction in this area. Over time, the Federal government has assumed the role of regulator of charities in the public interest - mostly as a result of its management of the income tax system and the donation tax credit. And so today, the Income Tax Act includes a variety of provisions designed to regulate the charitable sector and not simply to register charities. This is notwithstanding the fact that the Federal government’s jurisdiction is restricted to levying an income tax and, incidentally, maintain any registration system for that purpose. The result is a system where there are some rules which are in the best interests of Canadians but which have no sensible set of punishments and other rules which do not exist because the Federal government does not have the jurisdiction to legislate them. By way of example, inappropriate political advocacy either results in no punishment or deregistration as a charity. And there are no legislated rules pertaining to overspending charitable funds on administrative matters. Indeed, apropos the Committee’s concerns with respect to foreign funding of charities it may well be outside the jurisdiction of the Federal government to legislate on the topic.

There are two great harms caused because the Provinces are not involved in regulating the sector. The first is the inability of government to create a regulatory scheme to help grow the sector in a manner which befits the work it does for society. The second is that an incomplete regulatory regime creates suspicions amongst Canadians about the integrity of the sector. Such reservations are a disincentive to donating. **Thus, the best way to meet all of the Committee’s concerns is to involve the Provinces in regulating the sector.**

This can be done through the creation of a joint federal-provincial regulator of charities. The point of such an entity would be to ensure that proper regulations are in place that can govern charities and to ensure that such a system is harmonized across the Provinces. We would recommend that a dialogue be opened with the Provinces at the earliest opportunity to explore the possibility of better regulation of the sector.

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**The Definition of Charity**

It should be taken as axiomatic that to encourage donors to give to charity one must have a charity which appeals to the donor. To date, we rely on the judiciary to evolve the definition of charity in accordance with our changing times. However, over the past 30 years such evolution has effectively stopped. There are several reasons for this, primarily the subtle inclusion of charity regulation within the income tax system. Regardless of the reason, society is changing increasingly quickly and the Courts simply have been unable or unwilling to keep up. Moreover, many are now distrustful of relying on an activist judiciary to modernize such a large and important sector of our society.

We submit that Canada follow Britain in legislating a definition of charity to ensure that the causes which people wish to contribute to actually qualify as charitable status. And to ensure that Canada’s society development is driven by an activist Parliament rather than a passive judiciary.

**Tax Incentives**

For charitable contributions in excess of \$200 in the year, Canada’s donation tax credit system is extremely generous. (On the other hand, contributions less than \$200 are treated in a miserly fashion as we discuss below). Fundamentally, it allows personal taxpayers who are in the highest tax bracket to completely offset the tax that would have been paid on a dollar earned. (Put another way the government foregoes the tax on a dollar donated and contributes it to the charity). Personal taxpayers in brackets less than the highest not only do not pay tax on the dollar donated but actually receive a credit on the remainder of their taxes. For example, a donor in the second highest tax bracket would see the taxes she would have paid on a dollar donated directed toward the charity and in addition receive a 3 cent reduction on her Federal taxes otherwise owing. We submit that for donations greater than \$200 the system is quite generous and urge the Committee not to propose changes.

**Carrying Back the Credits**

Nevertheless, we submit that there are mechanisms which may serve to act as an additional incentive to charitable giving. First, given the generosity of our tax credit system it is clear that those with means, and who understand the system, make donations intended to reduce their tax payable (generally through the donation of publicly traded shares). One way to help motivate such people to donate in a year is to allow the carry back of those donation tax credits to the previous calendar year. In this way, donors can make an informed decision about the tax effects of their donation. We propose that donors to registered charities in the first 60 days of the calendar year be allowed to use the resulting donation tax credits against their tax owing in the previous year.

**Educating Donors**

There is another benefit to this suggestion. We believe that no incentive will truly motivate charitable giving unless the incentive is understood by potential donors. One way to ensure such understanding is to create an atmosphere whereby charities and donors can focus on the tax aspects of giving which simply does not happen now. The current deadline, coming as it does during the

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holiday season, creates an atmosphere that reinforces giving for sentimental or religious reasons. Obviously, this will not change should the deadline to use donation tax credits be delayed. Rather, a new season for donating will be created - akin to RRSP season - whereby donors can be educated by charities on the tax effect of their donation. Moreover, the contemporaneous deadline of the two financial decisions will likely reinforce financial literacy on the subjects.

### **Removing the Disincentive to Donating**

There is currently a limit on the total donation tax credit that can be used in any year (except the year of death and the year preceding it). The general limit allows a taxpayer to offset the tax owing on up to 75% of taxable income, but over time exceptions to this limitation were made for donation of certain types of assets. The effect is to create a disincentive for the donation of cash in favour of certain capital assets. At this point, we would submit that the limit has been raised to the point where it is practically meaningless as few people or corporations are in a position to even approach this limit. Nevertheless, as it only serves as a disincentive to giving cash it should be removed.

### **Abolishing the Two Tier Credit**

The current system credits personal taxpayers on the first \$200 of donations at a rate equal to the lowest marginal tax rate. We submit that there is no logic to such treatment. Our system is a progressive one which increases the tax rate at specific levels of income. And, as described above, the basic idea with respect to charitable giving is that donors should not pay tax on a dollar they have given to charity. For any donor with income greater than the first tax bracket this is not the case and in fact he or she does pay tax on a dollar they give to charity. We would submit that by eliminating the false dichotomy between these two areas, tax reporting would be immensely simplified and the vast majority of donors (comprising the lower middle to the highest income classes) would not be provided with a disincentive from giving their first \$200.

### **Conclusion**

We believe that the key to increasing donations to charity in Canada is to adopt a new mindset about our system of charitable regulation. This cannot be overstated, as a sector without the continued trust of the public cannot continue in its good work. Further, the tax treatment of donations should be fully understood by the public so that decisions about giving can be made in appreciation of their final after tax cost to the donor. We believe our suggestions open the door to this new mindset and will help to grow a strong and vibrant charitable sector.

Respectfully Submitted,

Arthur B. C Drache C.M., Q.C., LL.B.  
Adam Aptowitzer LL.B.

## **About the Authors**

Arthur B. C Drache C.M., Q.C., is Canada's most experienced charity law lawyer. After obtaining his LL.M. from Harvard, Mr. Drache worked for the Department of Finance where he drafted many of the charity law provisions currently under discussion. Amongst other work Mr. Drache has lectured in Public Policy in Canada and abroad, written several books, wrote a weekly tax column in the Financial Post for almost thirty years and published the Canadian Taxpayer for 34 years and the Not for Profit News for 25 years. He is the immediate past Chair of the International Centre for Not for Profit Law based in Washington D.C..

Adam Aptowitz has been practicing at the intersection of tax and charity law for the past ten years and is in the position of evaluating the qualitative effects of incentives on charitable donations. Mr. Aptowitz has published in several industry publications and in 2009 published a major paper with the C.D. Howe Institute regarding charitable regulation. A second paper with the C.D. Howe Institute will be published some time in 2012.