SUBMISSION TO:

THE SPECIAL SENATE COMMITTEE

ON THE CHARITABLE SECTOR

APRIL 2018

OBJECTIVE: **STRENGTHEN THE ENTIRE CHARITABLE SECTOR BY INTRODUCING A MEASURE IN THE 2019 BUDGET THAT WOULD INCREASE CHARITABLE DONATIONS BY AN ESTIMATED $200 MILLION PER ANNUM.**

RECOMMENDATION: **REMOVE THE CAPITAL GAINS TAX ON CHARITABLE GIFTS OF PRIVATE COMPANY SHARES AND REAL ESTATE THE SAME AS FOR LISTED SECURITIES.**

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Executive Summary

How the 2019 Budget can Stimulate a $200 Million Increase in Charitable Donations

We would like to congratulate the Senate for creating a Special Committee for the charitable sector which will conduct hearings and issue a report with recommendations in December.

The 2015 budget, which had the support of all three parties, included a measure that would likely have increased annual charitable donations by $200 million. The measure stated that, if the owner of private company shares or real estate sold his or her asset to an arm's-length party and donated all or a portion of the cash proceeds to a registered charity within 30 days, he or she would be exempt from capital gains tax. To most observers' surprise, the 2016 budget stated that the government would not proceed with this measure. The purpose of this submission is to outline why this proposal should be included in the 2019 budget.

Why this Proposal is Both Good Public Policy and Good Politics

- It addresses an inequity in the current Income Tax Act regarding the tax treatment of charitable donations of listed securities compared to donations of two other appreciated capital assets – private company shares and real estate.
- There is a broad level of awareness and support of this measure among all stakeholders in the charitable sector across Canada.
- It helps our hospitals, universities and research institutes attract the best and the brightest talent.
- The mayors of all cities, towns and villages across Canada are supportive of this measure.
- The primary beneficiaries are the millions of middle class Canadians served by our charitable sector. The measure provides an opportunity for people with appreciated capital property to share their wealth for the benefit of all Canadians.

Addressing Concerns

Here is a summary of the concerns which are addressed in the main body of this submission:

- ***Federal tax revenue costs.*** The foregone capital gains tax on these donations is only $50-65 million per annum and the Charitable Donation Tax Credit is the same as gifts of cash.
- ***The potential for valuation abuse.*** The donor must sell the assets to an arm's-length party, which ensures that he or she receives fair-market value for the sale.
- ***Some contend that Canada's charitable tax incentives are already very generous.*** The proposal removes an inequity in the current Income Tax Act. It provides the same tax treatment for donations of private company shares and real estate that currently apply to gifts of the other appreciated capital assets – listed securities.
- ***Substitution of private company shares and real estate for cash donations.*** Experts estimate that 90-95% of these donations would be incremental and only 5% or 10% substitution.

We urge the Special Senate Committee on the Charitable Sector, a laudable and timely initiative of the Senate, to recommend that the Government implement this measure in the 2019 budget. It will be a great legacy for all Canadians for generations to come!

Introduction

The 2015 budget included a measure that if the owner of private company shares or real estate sold the assets to an arm's-length party and donated the cash proceeds to a registered charity within 30 days, he or she would be exempt from any capital gains tax on that portion of the cash proceeds that were donated to a charity. The measure had the support of the Conservatives, the Liberals and the NDP. Although the measure was in the budget, it was not included in the Budget Bill that was passed in June 2015 because the legislative documents had not been drafted and it was not going to become effective until January 1st, 2017. Consequently, the measure was not enacted into law.

All stakeholders in the not-for-profit sector were surprised and disappointed that the 2016 budget stated that the government was not going to proceed with this measure and neither the 2017 nor the 2018 budget addressed this important public policy issue. The 2019 budget provides an opportunity for the government to reintroduce this measure and stimulate an estimated additional $200 million per annum in charitable donations. This funding will benefit the millions of Canadians who are served by our hospitals, social service agencies, colleges and universities, arts and cultural organizations and religious organizations. Many business owners believe that their wealth should go back into society for the greater good rather than being concentrated in the hands of a few family members. At a time when government funding for social programs is being reduced, having a strong, vibrant third sector becomes even more important. As the government's agenda is to help the middle class, whether the definition "middle class" is determined by income or net assets, implementing this measure should help the middle class business and real estate owners to be in a fairer tax position.

Why this Proposal is Both Good Public Policy and Good Politics

- ***Addressing an inequity in the current Income Tax Act.*** In the current tax system, entrepreneurs who start a company, take the company public and donate shares to a charity are exempt from capital gains tax on their gift. However, entrepreneurs who start a company and keep it as a private corporation do not have the same tax treatment. They do not have the opportunity to give back to their communities like entrepreneurs who have public companies. This measure would remove an important inequity in the current tax system.

- ***A broad level of support across the charitable sector.*** The management, volunteer board members and 2.1 million Canadians who are employed by our not-for-profit sector are naturally supportive of this proposal. Their organizations will benefit from increased private sector funding at a time when governments at all levels are facing fiscal challenges. The tens of thousands of business and community leaders who give back to their communities by serving as volunteer board members clearly understand and fully support this proposal. In addition to providing advice and oversight to the management of these organizations, they are all involved in fundraising as well as donating personally. They clearly recognize this proposal is the single, most relevant action which the government can take to stimulate more private sector donations.

- ***Going from being "good" to being "great".*** Government funding is crucial to providing all Canadians with essential services in healthcare, education, social services and arts and culture. Understandably, this funding needs to be distributed broadly to tens of thousands of not-for-profit organizations across each sector. Government funding enables each of these organizations to be "good". Experience has shown that private sector donations are crucial to enabling some of these organizations to grow from being "good" to becoming "great".

- ***Attracting the best and the brightest.*** In order for Canada to attract the best and the brightest healthcare professionals, professors, research scientists and other leaders in the not-for-profit sector, we need to have the government and the private sector partner to build and support organizations that are the best in Canada and have the potential to be recognized as one of the best internationally. Major donations from the private sector are crucial to achieving this objective. Implementing our proposals would stimulate a large number of major donations focused on supporting organizations that are the best in Canada and have the potential to be recognized as one of the best in the world.

- ***Canada's Competitive Position vs the United States.*** The government needs to respond to the recent corporate tax cuts in the United States to make sure we are competitive. We compete with the United States not-for-profit organizations for the best and the brightest talent. Our proposal would level the fundraising "playing field" with our United States counterparts who currently have a competitive advantage in fundraising from the private sector.

- ***Mayors of Municipalities.*** The mayors of all municipalities across Canada are supportive because not-for-profit organizations in their municipalities would receive additional private sector funding with no fiscal cost to the municipality. Municipalities derive their revenues from property taxes, not income taxes. On January 24, 2013 the Federation of Canadian Municipalities (FCM) passed a Resolution "**RESOLVED**, That the Federation of Canadian Municipalities (FCM) urge the federal government to amend the Income Tax Act (Canada) by removing the capital gains tax on gifts to charities of private company shares and real estate in the upcoming federal budget; and be it further **RESOLVED,** That the Federation of Canadian Municipalities and the Association of Municipalities request similar endorsement of all their members in good standing; and be it finally **RESOLVED**, That this resolution be forwarded, for immediate attention and action to: the Prime Minister of Canada, the Right Honourable Stephen J. Harper, as well as Canada's Minister of Finance, the Honourable James M. Flaherty, and all local Members of Parliament."

- ***Provincial Governments***. The premiers and provincial ministers of finance should all be supportive of this proposal. The fiscal cost is borne two thirds by the federal government and one third by the provinces. However, provinces provide direct funding for healthcare and education which are the two largest government expenditures. Implementing this measure would enhance the federal government's relationship with all of the provinces and territories.

- ***Supporting the Middle Clas****s*. The government's focus is on providing support for the middle class and increasing taxes on the wealthy. The prime beneficiaries of our proposal are the millions of middle class Canadians who benefit from the vital services provided by our hospitals, our social service agencies such as United Way/Centraide, as well as universities, colleges and arts and cultural organizations. Essentially, our proposal is a voluntary tax on the wealthy as they are contributing a portion of their wealth to help fund our vital charities.

Addressing Concerns about Our Proposal

The balance of this Submission will address all concerns expressed by the Department of Finance, as well as Members of Parliament, Senators and senior civil servants.

Federal Tax Revenue Cost

The federal tax revenue cost of the proposal depends on the amount of the increase in charitable gifts of private company shares and taxable real estate and the adjusted cost base (ACB) of the donated property. The C.D. Howe Institute hosted a conference on Strengthening Charity Finance in Canada on March 8th, 2011. A presenter estimated that our proposal would result in an annual increase in charitable giving in the form of private company shares and real estate of $170 to $225 million and the tax revenue cost to the federal government of the foregone capital gains tax would be only $50 to $65 million.

The fiscal cost to the federal government of the Charitable Donation Tax Credit would be the same as $200 million of cash donations, or approximately $60 million. The fiscal cost of the foregone capital gains tax is only 0.002% of the projected budget deficit and the combined fiscal cost to the federal government of the foregone capital gains tax and the CDTC is only 0.004% of the deficit. The fiscal cost of this measure does not cause a material increase in the deficit. These estimates were based upon an analysis of the Department of Finance's Annual Tax Expenditure Report, taking into consideration the percentage of donations of appreciated capital property in the United States that are made in the form of private company shares and real estate.

Concern about the Potential for Valuation Abuse

Any concern about the potential for valuation abuse is addressed by the provision in the measure that the donor must sell the assets to an arm's-length party and donate the cash proceeds to a charity within 30 days of the closing of the sale. Since the purchaser must be at arm's-length from the donor and the donor will logically obtain the highest possible price for the asset, this provision addresses any concern about the potential for valuation abuse.

Concern that Canada's Charitable Tax Incentives are Already Very Generous

These proposals address an inequity in the current Income Tax Act. The exemption from capital gains tax on gifts of listed securities is already a fundamental public policy principle of both Liberal and Conservative governments. The same principle should apply to gifts of other appreciated capital property – private company shares and real estate. In the United States, gifts of appreciated capital property are exempt from capital gains taxes. These include listed securities, private company shares and real estate.

Concern about Substitution of Private Company Shares and Real Estate for Cash Donations

The donations of private company shares and real estate would be largely incremental donations, not substitutions for cash donations. For example, a friend of mine has been a minority shareholder in a private company for over 25 years. He can sell his shares any time at fair market value to the controlling shareholder. If the capital gains tax on private company shares is removed in the 2019 budget, he will donate $6 million to two prominent charitable organizations. If it is not included, he will simply continue to hold his shares. His annual cash donations to charities are approximately $25,000. His $6 million donations would be incremental.

Capitalizing on the Success of the Removal of the Capital Gains Tax on Gifts of Listed Securities

In 1997, the federal government reduced the capital gains tax on donations of listed securities by 50% on a five-year trial basis. In 2006, the federal government removed the remaining capital gains tax on gifts of listed securities. Prior to 1997, Canadians did not donate listed securities to charities because when they transferred the shares to the charity, they were deemed to have sold the shares and were required to pay a capital gains tax on the donation. Since 2006, charities have received donations of over $1 billion virtually every year. The 2019 budget provides a unique opportunity to capitalize on this enormous success and increase charitable donations by an additional $200 million per annum.

We urge the Special Senate Committee on the Charitable Sector to recommend that the government implement this measure in the 2019 budget.