Charitable Incentives and
the Evolution of Public Benefit

A Submission to

Special Senate Committee on the Charitable Sector

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Introduction

This Special Senate Committee on the Charitable Sector is a unique opportunity to review the structure and regulation of the charitable sector, as well as tax incentives for charitable donations. I am grateful for the invitation to participate. My views are my own.

By way of introduction, I am a Toronto-based philanthropic advisor for the last 29 years working at charities and for Scotiatrust. I am Head, Philanthropic Advisory Services at Scotia Wealth Management, which is part of Scotiabank. We are the largest national service provider to private foundations and operate Aqueduct Foundation, a public foundation. Nationally, we facilitate more than $250 million in grants and private donations annually.

My interest in charitable policy stems from my work with private clients as they plan significant lifetime and legacy gifts, as well as my 30-year involvement as a volunteer in the charitable sector. I have been fortunate to contribute to the debate on charitable policy through the Canadian Association of Gift Planners, Imagine Canada, *The Philanthropist* journal, The Muttart Foundation, CRA's Charities Directorate, and the C.D. Howe Institute.

Today, I'd like to focus my remarks on three topics: 1) the state of the Canadian donation incentive regime; 2) the proposal for the elimination of capital gains on donations from taxable real estate and private securities; 3) the evolution of charity in Canada.

I. State of Canadian donation incentive regime in the Income Tax Act

Change to the Income Tax Act since 1996 have made Canada donation tax incentives incentive regime arguably the most generous in the world. These incentives have focused on incenting exceptional donations from assets, including gifts by will, lifetime major gifts and public securities.

As other witnesses will undoubtedly document, these incentives have increased the value of gifts, but *not* the number of donors. Meanwhile, we have witnessed an increase in crowd funding – which is benevolence, not charity – that provides no tax benefits to the donor. While there are a variety of factors influencing the decline in Canadians reporting charitable donations on their tax returns, from policy perspective Canada has placed too much emphasis on donation tax credits to incent *ordinary* donations. We think it's the magic bullet.

As philanthropic research has consistently demonstrated, donations are motivated by a complex mix of altruism, values, faith, community connections and personal involvement. As the failure of incentives such as the First-time Donor Super Tax Credit demonstrates juicing the donation tax credit does little to motivate donor behavior. It does, however, cause the government to over-subsidize existing dollars flowing into the sector.

Canadians understand they receive tax savings for donating to charity, but they rarely know the value of the tax credit. Moreover, they are not influenced by the tax savings alone.

Here's a quick sketch of the incentives we have and what works.

1. Tax Credits: Since 1988 individual taxpayers in Canada receive tax credits for donations, not deductions. In 2016, the donation tax credit rates were increased to reflect increases in the Federal tax rate and a complex three-tier system was introduced. Poorly understood, donation tax credits are more beneficial than deductions for the majority of Canadian donors. In particular, middle income Canadians who donate over $200 per annum frequently receive tax credits worth twice their average tax rate. By contrast, the U.S. deduction system limits the donation tax benefit to the rate of tax owing.

2. Contribution Limit: Canada has the highest donation "contribution limit" in the world. Taxpayers may claim lifetime gifts equal to 75 percent of annual net income and 100 percent at death. During life there is a five-year carryforward of unclaimed receipts. At death, there is a two-year claim period plus a five-year claim window in the estate. (The claim period for "estate donations" was expanded in 2016.) The contribution limit facilitates exceptional gifts – "major gifts" or "planned gifts" – from assets, not ordinary gifts from income.

Charitable Canadians can offset up to 75 percent of their annual taxes by giving to charity. At death, income taxes can be eliminated. By contrast, U.S. limits range from 20 to 50 percent of income depending on the asset donated and recipient charity. Every Canadian who leaves a gift by will to charity will get some tax relief in their estate, and may even eliminate all taxes by giving to charity. By contrast, approximately 1 in 1,000 US estate donors – the richest – receives any tax relief.

3. Donations of Capital Property: Canada has extra incentives for gifts of certain types of capital property. Gifts of public securities, employee stock options, exchangeable shares, ecological land and cultural property are all exempt from capital gain (or equivalent employment benefit) when donated to charity. The capital gains exemption provides a second level of tax benefits for a donation. An individual who donates certain capital property first receives a tax credit of up to 54 percent (depending on the province) and up to 27 percent due to the elimination of capital gains (depending on the province and capital gain on the property donated). Incentives for gifts of capital property have become a key part of the Canadian donation regime to encourage gifts from and for capital.

The Income Tax Act has an extensive regime of charitable incentives, which includes numerous special incentives for particular asset classes. These include life insurance, registered funds, cultural property, ecological property, employee stock options and exchangeable shares. Canada's system is mature and there are few opportunities for productive expansion. At this point we need to understand our system and ensure incentives are not eroded or lost.

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There are a few examples of recent erosion of tax incentives, partly statutory and partly judicial. The 2016 Federal personal tax increases triggered a donation tax credit reduction for donors at top marginal rates in some provinces, most notably Ontario. In June 2018, a Federal Court of Appeal ruling under the Cultural Property Export and Import Act has resulted in a freeze on donations to Canadian museums of foreign works of art to be designated as cultural property. This has created a crisis in the art world.

2. Eliminating capital gain on gifts of proceeds of sale of taxable real estate and private company shares.

Although Canada has a mature system of tax incentives, there are two major classes of capital property that do not have special donation incentives. These are taxable real estate and private company shares. This is not a new idea, and indeed, a fully-developed law was slated to be implemented in 2017 before cancellation due to the change in Government.

In 2009 and 2011, I wrote papers for the C.D. Howe Institute advocating that these two asset classes be incented for donation purposes, but only in certain circumstances. *In-kind* donations of these two asset classes are problematic and raise valuation and management issues. The rationale for the incentive was to unlock wealth owned by private business owners and real estate investors. There are two additional important public policy objectives: equity among taxpayers who own different asset classes (public and private businesses) and the support of charities in smaller cities and communities. Outside big cities, wealth is created through private companies and real estate. Incenting donations of these asset classes will help ensure charities in smaller communities get their fair share of major donations.

In my C.D. Howe papers I recommended that the incentive be tied to donating cash to one or more charities within 30-days of a sale of private shares or real estate. The logic was to eliminate valuation issues, ensure all charities could benefit by removing charity management issues of complex property (charities get cash!), and incent donors. The mechanism also makes it easier to donate a portion of sales proceeds. This proposal – donating cash within 30 days of a sale and eliminating the proportionate share of the capital gains – was adopted in the legislative proposal.

The provisions tabled by the Department of Finance in 2015 have been criticized by many in the tax planning community as too complex and restrictive. This includes the cash proceeds mechanism. While the proposed rules are complex, I am of the view that this donation incentive needs to have restrictions to balance interests and preserve public policy aims. Some planning scenarios will be restricted by the 2015 provisions, but the proposed rules will generally open the door for wealth creators to "give back" to charities in the community at the time of a major asset sale.

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3. Evolution of the definition of charity in Canada

Although this day of hearings is focused on donation tax incentives, I would be negligent if I did not urge this Committee to champion the evolution of the definition of charity. As the September 14, 2018 legislative proposals on political activities demonstrate, this is an area of current concern.

Canadian charity law is derived primarily from Common law, starting with the Statute of Elizabeth in 1601. Canada has fallen behind other common law jurisdictions in evolving charity law to meet the needs of contemporary society. In Canada, the biggest inhibitor is the appeals process.

I encourage the Committee to recommend an amendment to the Income Tax Act to allow appeals from refusal to register or revocations cases go to the Tax Court Canada. Currently, these appeals go to the Federal Court of Appeal, which reviews the existing CRA file. Appeals to the FCA have meant little progress in the definition of charity law in almost 30 year. Charities don't appeal. The CRA has, *de facto*, defined charity law through the administrative process.

Other decisions under the Income Tax Act go to Tax Court. Registered Charities and applicants, by contrast, have no practical legal recourse under the current system. The law of charity, which should be dynamic, is being stunted. This change can be accomplished at little cost and would have a significant long-term effect on allowing charity law in Canada to evolve.

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