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March 17, 2004

Roy Cullen, M.P.
Chair, Finance Committee
House of Commons
6th Floor, 180 Wellington Street
Ottawa ON K1A 0A6

Dear Mr. Cullen:

Re: Charitable Donations of Publicly Traded Securities

I am writing on behalf of the National Charities and Not-for-Profit Law Section of the Canadian Bar Association (the CBA Section), with regard to the special tax assistance for charitable donations of publicly traded securities. This issue was raised before your committee in the pre-budget consultations, in the context of two articles in the Canadian Tax Journal.[1] Both articles deal with the onus on the federal government to justify retaining or expanding paragraph 38(a.1) of the *Income Tax Act* (ITA), which reduces by 50% the usual inclusion of taxable capital gains and income when appreciated securities are donated to charitable organizations and public foundations.

The CBA Section believes that the incentives in paragraph 38 (a.1) should be retained. In addition, the same underlying concept should be expanded to a broader range of property and a broader range of recipient charities.

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1 Lisa Philipps, *Thinking Critically About the Taxation of Capital Gains on Donated Public Securities (or Looking Paragraph 38(a.1) in the Mouth)* and David G. Duff, *Special Federal Tax Assistance for Charitable Donations of Publicly Traded Securities: A Tax Expenditure Analysis,* both published in the Canadian Tax Journal, (2003) Volume 51, No. 2, at pages 913 and 925, respectively.

Treatment of Charitable Donations

Finance Canada characterizes any tax measure that takes account of charitable donations as a tax expenditure which the government, in effect, grants out of the goodness of its heart. This attitude was reinforced some years ago by the substitution of tax credits for deductions from the income of individuals, in response to a campaign of a non-governmental group at the time, using reasoning that many would disagree with. The use of tax credits clearly suggests that they are a tax expenditure rather than a proper deduction in arriving at normative income, which we believe is more appropriate. The CBA section considers that a person who earns, say, $50,000 and makes charitable donations of $2,000 has the same capacity to pay taxes, and the same normative income, as someone who earns $48,000 and gives nothing to charity.

Even if one accepts that tax incentives for charitable giving are a form of tax expenditure, we submit the Canadian Tax Journal articles have not made a persuasive case to eliminate or curtail the current incentives in paragraph 38(a.1). Indeed, we believe that there is scope to expand the incentives provided by paragraph 38 (a.1):

- by extending the same underlying concept to a broader range of property, such as real estate, and to a broader range of recipient charities to include private foundations; and
- by eliminating the capital gains tax altogether on these donations.

Impact of paragraph 38 (a.1)

(a) Increase in donations

The experience of many members of the CBA Section confirms that donations of securities have increased significantly as a result of the introduction of paragraph 38 (a.1). An example will best demonstrate the positive impact. If a gift of shares to a public charity has an adjusted cost base of $1 million and a fair market value of $10 million, this will result in a capital gain of $9 million. But for paragraph 38(a.1), this would result in the inclusion of $4.5 million in the income of the donor and, at the top marginal tax rate in Ontario, tax of $2,070,000. Since the tax credit for a person in the top tax bracket is substantially the same as a deduction, the tax credit at 46% on a gift of $10 million would be $4,600,000. As a result, the net tax benefit for the generosity of the donor would be $2,530,000 or only 25.3% of the total value of the gift.

With the benefit of paragraph 38(a.1), the figures change dramatically: the tax on the gift is reduced to $1,035,000, while the tax credit is still $4,600,000. The net tax benefit to the donor becomes $3,565,000, or 35.65% of the total value of the gift. This is a considerable incentive. Indeed, it has led some donors to make significant gifts that they never would have otherwise made.

The increase in large donations has offset what appears from the Finance Canada study to have been a significant drop in the total number of smaller donations, with the result that the total level of donations has not increased materially. However, the increase in large donations may well have prevented what might otherwise have been an overall drop in the total level of donations. We believe that paragraph 38(a.1) has fulfilled its goal of increasing donations over the level at which they otherwise might have been made, but for the concession for capital gains.

(b) Distribution of charitable donations

The second requirement of Finance Canada in making these rules permanent was that the increase must have been distributed fairly among charities. The CBA section submits this is also the case. If large donations had been directed to charities with particular narrow objectives, one might properly object that the focus was too narrow. However, the Finance Canada study shows that the large donations have been directed almost exclusively to educational institutions and for medical care, generally considered to be areas to which donations would otherwise be directed in any event, based on sound policy considerations.

Mr. Duff argues that, because they have not been directed to various charities in the same proportions as they were before paragraph 38(a.1) was enacted, there is evidence of an unfair distribution. This seems to overlook completely the significant benefits derived by larger organizations, such as the University of Toronto, for both higher education in general and medical research in particular.

(c) Distributions to small charities

Significant indirect but real benefits often filter through to smaller charities from larger charities (frequently public foundations), either directly of the donor's wishes or as result of a program of the recipient charity that supports smaller charities.

Many small charities are not equipped to receive gifts of securities, since they do not have brokerage accounts or sophisticated staff or systems and they are not able to deal with securities received in kind. Frequently, gifts of securities to be distributed among small charities are made to a larger charity, such as a foundation, which distributes the proceeds from the sale of the securities to the target charities in accordance with the donor's wishes. Many private foundations undertake direct charitable activities but are designated as private foundations because their directors or trustees are considered not to be at arm's length or because they receive substantial funding from a narrow source. The rules treating these charities as private foundations contribute to the difficulty faced by donors seeking to diversify their gifts. Where the target charity is a private foundation, a gift to a public foundation on a donor-advised basis or on the understanding that the public foundation will assist the private foundation is the only way a donor wishing to give marketable securities can assist the private foundation. In our view, this necessarily skews the data.

The CBA section considers that the extent of this distribution of donations cannot be measured accurately, but we think it is an overlooked factor that should be given weight. We believe there is a substantial benefit to smaller charities directly attributable to the incentive to give marketable securities. This would be more apparent if the gifts could be made directly to private foundations.

Additional Considerations

The CBA Section also proposes amendments to sections 149.1(2), ss 149.1(3) and ss 149.1(4) of the ITA, by eliminating the requirement that the donee be a "qualified donee" at the time of the gift. While many foundations and charities are accustomed to entering into agency agreements with foreign charities in order to permit the donor to treat the agent's expenditures as those of the donor, it is simply impractical for a substantial foundation or charitable organization to make relatively small donations of, say, $5,000 to $10,000 in this manner, since the cost of negotiating and monitoring the agency agreement is simply not cost effective. We believe that it is sufficient that, once a Canadian charitable organization or foundation has met its annual disbursement quota for a particular year, it should be free to make gifts to bona fide foreign charities out of its excess funds.

The CBA Section also submits that if Canadian charitable institutions are to compete effectively on the world scene, they should not be burdened with a less generous tax incentive system than is currently available in the United States.

The CBA Section maintains its position that the incentive in paragraph 38(a.1) should be retained and expanded, and that a persuasive case for doing otherwise has not been demonstrated.

Yours truly,

Original signed by Trevor Rajah for Gavin Wyllie

Gavin Wyllie
Chair
National Charities and Not-for Profit Law Section