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# Special Federal Tax Assistance for Charitable Donations of Publicly Traded Securities: A Tax Expenditure Analysis

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**KEYWORDS:** CHARITABLE DONATIONS ■ TAX EXPENDITURES ■ TAX INCENTIVES ■ SECURITIES ■ CAPITAL GAINS

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## INTRODUCTION

More than 30 years ago, Harvard Law School Professor Stanley Surrey developed the concept of tax expenditures to analyze special tax rules that reduce otherwise applicable taxes in order to encourage specific kinds of social or economic behaviour.<sup>1</sup> Contending that these rules were functionally equivalent to direct expenditures, Surrey suggested that they should be evaluated in the same way as government spending programs, with their projected social and economic benefits weighed against their cost in terms of forgone revenues that would otherwise have been collected.

Consistent with this approach, the US Congress enacted legislation in 1974 mandating the inclusion of a tax expenditure budget in the annual budget report of the US government.<sup>2</sup> In 1979, the federal Department of Finance published Canada's

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1 See Stanley S. Surrey, "Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures" (1970) vol. 83, no. 4 *Harvard Law Review* 705-38. For more extensive treatments, see Stanley S. Surrey, *Pathways to Tax Reform: The Concept of Tax Expenditures* (Cambridge, MA: Harvard University Press, 1973); and Stanley S. Surrey and Paul R. McDaniel, *Tax Expenditures* (Cambridge, MA: Harvard University Press, 1985).

2 Congressional Budget and Impoundment Control Act of 1974, Pub. L. no. 93-344, enacted on July 12, 1974. For an excellent account of the origins of the tax expenditure budget in the

first tax expenditure account,<sup>3</sup> although the practice of annual tax expenditure estimates was adopted in Canada only in the 1990s. While the estimation of actual tax expenditures is not uncontroversial,<sup>4</sup> the publication of a regular tax expenditure budget is generally viewed as a valuable method of promoting transparency and accountability in government decision making, thereby limiting inequitable and inefficient rent seeking by special interests and preventing the use of the tax system to implement indirect spending programs that would not withstand scrutiny as direct expenditures.<sup>5</sup>

Among the many tax expenditures estimated in the most recent Canadian analysis, part 2 of the report singles out special tax assistance for charitable donations of publicly traded securities for detailed examination.<sup>6</sup> Introduced in order to encourage large donations of capital to Canadian charities by providing a level of tax assistance for gifts of publicly listed securities “comparable to that in the US,”<sup>7</sup> this provision reduces the capital gains inclusion rate for these charitable contributions to one-quarter from the otherwise applicable rate of one-half.<sup>8</sup> The measure, which was announced in the federal budget of February 18, 1997, was initially applicable only to donations made before 2002.<sup>9</sup> The budget announcement stipulated that the continuation of the provision beyond the initial five-year period was conditional upon its effectiveness in “both increasing donations and distributing the additional donations fairly among charities.”<sup>10</sup> The measure was made permanent in 2002,<sup>11</sup> after the minister of finance issued a special release announcing that the incentive had proven to be “an effective additional incentive for people to make donations to

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United States, see Jonathan Barry Forman, “Origins of the Tax Expenditure Budget” (1986) vol. 30, no. 6 *Tax Notes* 538-45.

- 3 Government of Canada, *Tax Expenditure Account* (Ottawa: Department of Finance, 1979). For useful reviews of this report by Stanley S. Surrey and P.J.W. Hardwick, see “Reviews: Government of Canada Tax Expenditure Account” (1980) vol. 2, no. 1 *Canadian Taxation* 60-68.
- 4 As critics and advocates of the tax expenditure concept have observed, the characterization of a tax expenditure depends on contested concepts of the benchmark or normative tax regime, while the computation of forgone revenues generally depends on simplifying assumptions regarding the impact of the provision’s repeal on social and economic behaviour and other tax provisions. These limitations are acknowledged in the government of Canada’s most recent tax expenditure account: Canada, Department of Finance, *Tax Expenditures and Evaluations 2002* (Ottawa: Department of Finance, 2002), 9.
- 5 See, for example, Julie Roin, “Truth in Government: Beyond the Tax Expenditure Budget” (2003) *Hastings Law Journal* (forthcoming), available online at [http://ssrn.com/abstract\\_id=350981](http://ssrn.com/abstract_id=350981).
- 6 *Tax Expenditures and Evaluations*, supra note 4, at 59-74. In addition to this provision, part 2 also examines the impact of the Canada child tax benefit on the incomes of families with children.
- 7 Canada, Department of Finance, 1997 Budget, Budget Plan, February 18, 1997, 114.
- 8 See paragraph 38(a.1) of the Income Tax Act, RSC 1985, c. 1 (5th Supp.), as amended (herein referred to as “the Act”). Unless otherwise stated, statutory references in this article are to the Act.
- 9 See paragraph 38(a.1) as it read before 2002, added by SC 1998, c. 19, section 6.
- 10 Supra note 7, at 114.
- 11 See SC 2002, c. 9, section 22.

charities.”<sup>12</sup> The detailed examination by the Department of Finance represents the federal government’s justification for making the measure permanent.

This comment questions both the justification offered in the Department of Finance study and tax assistance for charitable giving in the form of a reduced capital gains inclusion rate on gifts of publicly traded securities. I begin by setting out what I consider to be the most persuasive rationale for special tax treatment of charitable contributions under the income tax and the implications of this justification for the design of an appropriate tax incentive. In light of this analysis, I then turn to the reduced capital gains inclusion rate on gifts of publicly traded securities and the justification offered in the Department of Finance study. A final section offers more general conclusions.

## TAX RECOGNITION FOR CHARITABLE CONTRIBUTIONS

Among tax scholars who have examined the tax treatment of charitable contributions under the income tax, tax recognition for these donations is generally favoured on one of three grounds.<sup>13</sup> For some, tax recognition for charitable contributions is necessary to define taxable income—either because these gifts do not constitute personal consumption under Henry Simons’s definition of the ideal income tax base,<sup>14</sup> or because they “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>15</sup> For others, tax assistance for charitable contributions is justified as a kind of social reward for individual generosity.<sup>16</sup> Yet others regard

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12 See Canada, Department of Finance, “Special Federal Tax Assistance for Charitable Donations of Publicly Traded Securities Made Permanent,” *Release* no. 2001-089, October 12, 2001.

13 For a more detailed discussion of these perspectives, see 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, ON: McGill-Queen’s University Press for the Non-Profit Sector Research Initiative, 2001), 407-56, at 426-36.

14 See William D. Andrews, “Personal Deductions in an Ideal Income Tax” (1972) vol. 86, no. 2 *Harvard Law Review* 309-85. According to Simons, personal income is properly defined as the sum of personal consumption and savings. See Henry C. Simons, *Personal Income Taxation: The Definition of Income as a Problem of Fiscal Policy* (Chicago: University of Chicago Press, 1938), 49-50.

15 Boris I. Bittker, “The Propriety and Vitality of a Federal Income Tax Deduction for Private Philanthropy,” in Tax Institute of America, *Tax Impacts on Philanthropy* (Princeton: Tax Institute of America, 1972), 145-70, at 165. For a similar argument, see Mark P. Gergen, “The Case for a Charitable Contributions Deduction” (1988) vol. 74, no. 8 *Virginia Law Review* 1393-1450, at 1426-33.

16 See, for example, Bittker, *supra* note 15, at 166 (“something can be said for rewarding activities that in a certain sense are selfless, even if the reward serves no incentive function”); and Richard Goode, *The Individual Income Tax*, rev. ed. (Washington, DC: Brookings Institution, 1976), 165 (the US deduction for charitable contributions is characterized as a “reward” for charitable giving).

these measures as deliberate incentives that are designed to subsidize the quasi-public goods and services provided by the charitable sector by encouraging charitable donations.<sup>17</sup>

Elsewhere, I have rejected the view that tax recognition for charitable contributions is necessary to define taxable income and the argument that such recognition is justified as a reward for individual generosity.<sup>18</sup> Although the first of these grounds for tax recognition might support a deduction for charitable contributions, charitable gifts are best viewed as a voluntary transfer of amounts to which the donor is legally entitled, and therefore properly included in computing the donor's taxable income.<sup>19</sup> While the second rationale would seem to support a tax benefit geared toward a measure of the donor's relative sacrifice,<sup>20</sup> it is contradictory to provide a monetary reward for the virtue of generosity.<sup>21</sup> Instead, I have argued, tax recognition

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17 See, for example, 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), 1-28; Kimberley Scharf, Ben Cherniavsky, and Roy Hogg, *Tax Incentives for Charities in Canada*, CPRN Working Paper no. CPRN 03 (Ottawa: Canadian Policy Research Networks, 1997); and John D. Colombo, "The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and the Tax Exemption" (2001) vol. 36, no. 3 *Wake Forest Law Review* 657-703. To the extent that the charitable sector provides quasi-public goods and services, economic theory supports the subsidization of these activities in order to prevent their undersupply. See, for example, Harold H. Hochman and James D. Rodgers, "The Optimal Tax Treatment of Charitable Contributions" (1977) vol. 30, no. 1 *National Tax Journal* 1-18, at 2-3; and Gergen, *supra* note 15, at 1396-1414.

18 See Duff, *supra* note 13, at 426-30.

19 In addition to the arguments *ibid.*, at 426-29, see Gwyneth McGregor, "Charitable Contributions" (1961) vol. 9, no. 6 *Canadian Tax Journal* 441-49; Edward H. Rabin, "Charitable Trusts and Charitable Deductions" (1966) vol. 41, no. 5 *New York University Law Review* 912-37; Surrey, *Pathways to Tax Reform*, *supra* note 1, at 20-21; James A. Rendall, "Taxation of Contributions to Charitable Organizations Under the Income Tax Act," in *Report of Proceedings of the Twenty-Fifth Tax Conference, 1973 Conference Report* (Toronto: Canadian Tax Foundation, 1974), 152-60; and Krever, *supra* note 17, at 5-8.

20 See, for example, Paul R. McDaniel, "Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction" (1972) vol. 27, no. 3 *Tax Law Review* 377-413, at 394: "[I]f 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." Consistent with this approach, McDaniel proposed a matching grant for charitable contributions that would rise from 5 percent of aggregate donations from donors contributing less than 2 percent of their income to charities to 50 percent of aggregate donations from donors contributing more than 10 percent of their income to charities: *ibid.*, at 397. 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. See, for example, Bittker, *supra* note 15, at 169 (the floor should exclude the least generous 10 to 20 percent of donors); and Goode, *supra* note 16, at 165 (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").

21 In addition to the argument advanced in Duff, *supra* note 13, at 430, see E. Blake Bromley, "Charity, Philanthropy and Stewardship: A Philosophical Perspective on Tax Reform" (1988)

for charitable donations is best justified as a method of subsidizing the goods and services provided by the charitable sector by encouraging charitable donations.<sup>22</sup> More specifically, since these subsidies could also be delivered in the form of direct sustaining or matching grants,<sup>23</sup> the rationale for an indirect subsidy in the form of a tax incentive for charitable giving turns on the further conclusion that a tax incentive promotes a greater degree of social and cultural pluralism than direct subsidies by allowing donors themselves to select the activities to which they wish to direct a public subsidy through the choice of their charitable contributions.<sup>24</sup>

From this perspective, as with the other two rationales for the tax recognition of charitable contributions, it is possible to derive a number of implications regarding the form that such recognition might take.<sup>25</sup>

First, since the incentive is designed to subsidize the quasi-public goods and services provided by the charitable sector, it is often suggested that the value of any

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vol. 7, no. 2 *The Philanthropist* 4-23, at 12 (rewards for charitable contributions corrupt “the essential dignity and altruism of a simple gift”); Neil Brooks, “The Tax Credit for Charitable Contributions: Giving Credit Where None Is Due,” in *Between State and Market*, supra note 13, 457-81, at 464 (tax assistance for charitable giving “accentuates the purely selfish goal of reducing one’s own taxes”); and Gergen, supra note 15, at 1394 (if a society values altruism, why would it want to “sully” virtue with “a pecuniary reward”?) See also Colombo, supra note 17, at 677 (“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 of behaving altruistically”).

- 22 Duff, supra note 13, at 430-36. This argument is further developed in David G. Duff, “Tax Treatment of Charitable Contributions in Canada: Theory, Practice, and Reform,” *Osgoode Hall Law Journal* (forthcoming).
- 23 For a clear expression of the view that such subsidies should generally be delivered in the form of direct grants rather than tax incentives, see Brooks, supra note 21, at 467-72.
- 24 In addition to the argument in Duff, supra note 13, at 433-36, see Bittker, supra note 15, at 152 (“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, supra note 16, at 163 (it is “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) vol. 5 *Probate Lawyer* 1-92, at 82 (“The 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, supra note 17, at 25 (“[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) vol. 66, no. 3 *Tennessee Law Review* 687-763, at 757 (“[O]ne 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”). 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) vol. 65, no. 2 *University of Chicago Law Review* 387-431.
- 25 For a more detailed explanation of these implications, see Duff, “Tax Treatment of Charitable Contributions in Canada,” supra note 22.

tax benefit should vary according to the extent of the public benefit resulting from the charitable gift.<sup>26</sup> In practice, though, differentiation on this basis is likely to founder on the assessment of public benefits, which depends on value judgments that are often difficult to reconcile.<sup>27</sup> As well, since an indirect subsidy in the form of a tax incentive is designed to promote pluralism in the allocation of public funds, any differentiation in the value of the tax benefit is arguably inconsistent with the rationale for this kind of subsidy. In any event, as I have argued elsewhere, where differential tax incentives are justified on this basis, they should be explicit rather than concealed in the form of a tax incentive that implicitly favours specific types of donations over others.<sup>28</sup>

Second, to the extent that a tax incentive is designed to subsidize the charitable sector in a cost-effective way, it is arguable that it should apply only where the increase in charitable donations resulting from the measure exceeds the cost in terms of forgone revenue—a relationship that is determined by what economists describe as the “price elasticity of giving.”<sup>29</sup> Although empirical estimates of this relationship vary widely,<sup>30</sup> it is generally agreed that donations to religious organizations

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26 See, for example, Wayne R. Thirsk, “Giving Credit Where Credit Is Due: The Choice Between Credits and Deductions Under the Individual Income Tax in Canada” (1980) vol. 28, no. 1 *Canadian Tax Journal* 32-42, at 41-42 (“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”); Hochman and Rodgers, supra note 17, at 14 (“The 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 et al., supra note 17, at 9 (“we should try to encourage donations to charities that provide goods or services to a large number of consumers”).

27 Contrast, for example, Dennis B. Wolkoff, “Proposal for a Radical Alternative to the Charitable Deduction” [1973] no. 2 *University of Illinois Law Forum* 279-306, 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, supra note 21, 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”).

28 Duff, supra note 13, at 435-36. See also Neil Brooks, *Financing the Voluntary Sector: Replacing the Charitable Deduction* (Toronto: Law and Economics Workshop, 1981), 26 (“If certain activities are to be favoured over others, that choice should be clearly reflected on the face of the instrument chosen”).

29 For a useful introduction to this concept, see Scharf et al., supra note 17, at 8-9. See also the discussion in Duff, supra note 13, at 430-32. While a price elasticity less than unity indicates that the cost of the tax incentive in terms of forgone revenue exceeds the resulting increase in charitable donations, a price elasticity exceeding unity implies that the increase in charitable contributions attributable to the tax incentive exceeds the consequent reduction in tax revenues. Where forgone revenues from the incentive exceed the increase in charitable donations, it would be more cost-effective to finance the charitable sector through direct subsidies.

30 For useful 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) vol. 3, no. 4 *Canadian Taxation* 258-63; Charles T. Clotfelter, *Federal Tax Policy and Charitable Giving* (Chicago: University of Chicago Press, 1985), 16-99;

are price-inelastic,<sup>31</sup> suggesting that tax incentives for these kinds of donations are cost-inefficient. In contrast, one might expect that large donations of capital property are likely to be more responsive to the price of charitable giving than contributions out of annual income, which—like contributions to religious organizations—are more likely to reflect a sense of personal obligation.<sup>32</sup> On efficiency grounds alone, therefore, one might reject tax incentives for gifts to religious organizations and favour special tax assistance for gifts of capital property.

Efficiency, however, is only one goal of tax policy, and it is routinely balanced against equity considerations.<sup>33</sup> Moreover, in the context of a tax incentive for charitable contributions, the cost-effectiveness of the measure is presumably subordinate to its basic rationale to promote social and cultural pluralism.<sup>34</sup> For these

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Scharf et al., *supra* note 17, at 11-17; and Eleanor Brown, "Taxes and Charitable Giving: Is There a New Conventional Wisdom?" in *Proceedings of the Eighty-Ninth Annual Conference on Taxation* (Washington, DC: National Tax Association, 1997), 153-59. The earliest studies reported relatively low price elasticities of charitable giving, suggesting that tax incentives are a relatively inefficient means of funding charitable organizations. See, for example, Michael K. Taussig, "Economic Aspects of the Personal Income Tax Treatment of Charitable Contributions" (1967) vol. 20, no. 1 *National Tax Journal* 1-19; Robert A. Schwartz, "Personal Philanthropic Contributions" (1970) vol. 78, no. 6 *Journal of Political Economy* 1264-91; and R.D. Hood, S.A. Martin, and L.S. Osberg, "Economic Determinants of Individual Charitable Donations in Canada" (1977) vol. 10, no. 4 *The Canadian Journal of Economics* 653-69. Subsequent studies, however, reported price elasticities greater than unity, suggesting that tax incentives may be a cost-effective method of funding charitable organizations. See, for example, Martin Feldstein, "The Income Tax and Charitable Contributions: Part I—Aggregate and Distributional Effects" (1975) vol. 28, no. 1 *National Tax Journal* 81-100; Charles T. Clotfelter and C. Eugene Steuerle, "Charitable Contributions," in Henry J. Aaron and Joseph A. Pechman, eds., *How Taxes Affect Economic Behavior* (Washington, DC: Brookings Institution, 1981), 403-37; Harry Kitchen and Richard Dalton, "Determinants of Charitable Donations by Families in Canada: A Regional Analysis" (1990) vol. 22, no. 3 *Applied Economics* 285-99; and Harry Kitchen, "Determinants of Charitable Donations in Canada: A Comparison Over Time" (1992) vol. 24, no. 7 *Applied Economics* 709-13. More recent studies using different methodologies have reported much lower estimates of price elasticities, again calling into question the efficiency of tax incentives as a method of funding the charitable sector. See, for example, Richard Steinberg, "Taxes and Giving: New Findings" (1990) vol. 1, no. 2 *Voluntas* 61-79; Leonard E. Burman and William C. Randolph, "Measuring Permanent Responses to Capital-Gains Tax Changes in Panel Data" (1994) vol. 84, no. 4 *The American Economic Review* 794-809; William C. Randolph, "Dynamic Income, Progressive Taxes, and the Timing of Charitable Contributions" (1995) vol. 103, no. 4 *Journal of Political Economy* 709-38; Kevin Stanton Barrett, Anya M. McGuirk, and Richard Steinberg, "Further Evidence on the Dynamic Impact of Taxes on Charitable Giving" (1997) vol. 50, no. 2 *National Tax Journal* 321-34; and Pamela Greene and Robert McClelland, "Taxes and Charitable Giving" (2001) vol. 54, no. 3 *National Tax Journal* 433-53.

31 See, for example, Feldstein, *supra* note 30; and Kitchen and Dalton, *ibid*.

32 For an argument to this effect, though not expressed in economic terms, see Bromley, *supra* note 21, at 14-16.

33 See, for example, Martin Feldstein, "A Contribution to the Theory of Tax Expenditures: The Case of Charitable Giving," in Henry J. Aaron and Michael J. Boskin, eds., *The Economics of Taxation* (Washington, DC: Brookings Institution, 1980), 99-122, at 121.

34 In this respect, see Hochman and Rodgers, *supra* note 17, at 11: "Public policy involves much more than whether an additional dollar of subsidies can generate more than a dollar of charity."



reasons, one might question an incentive excluding gifts to religious organizations and providing additional tax assistance for gifts of capital property. On the contrary, as I have argued elsewhere, tax assistance for charitable contributions should not discriminate among organizations and activities having broadly defined public benefits, and should promote a genuine pluralism by encouraging a large number of donors rather than a small number of large donations.<sup>35</sup> On this basis, I have suggested, tax recognition for charitable contributions should ideally take the form of a refundable credit with a declining rate structure based on the amount claimed, thereby providing a larger subsidy for small and medium-sized donations and a smaller subsidy for large donations.<sup>36</sup>

### **SPECIAL TAX ASSISTANCE FOR CHARITABLE DONATIONS OF PUBLICLY TRADED SECURITIES**

On the basis of the argument in the previous section, a reduced inclusion rate for capital gains on gifts of publicly traded securities can be questioned on three grounds.

First, to the extent that this incentive is intended to encourage specific kinds of charitable giving—for example, to educational institutions<sup>37</sup>—this objective arguably conflicts with the underlying rationale of tax incentives for charitable giving to promote pluralism in the allocation of public funds. Moreover, even if such a policy could be justified, it should be explicitly acknowledged and made transparent in the form of an increased incentive for these types of donations, not concealed in the form of special tax assistance for donations of publicly traded securities.<sup>38</sup>

Second, although it is plausible to conclude that differences in the price elasticity of charitable giving might make this incentive more cost-effective than other kinds of tax assistance for charitable donations,<sup>39</sup> its distributional impact is arbitrary and inequitable, with the magnitude of the tax benefit increasing both with the amount of unrealized appreciation that happens to have accrued on the specific securities and with the donor's marginal rate of tax. Not surprisingly, therefore, the US Treasury department and tax scholars have long criticized the US rule that exempts gains on gifts of appreciated property while permitting a deduction for the full fair market value of the property.<sup>40</sup>

Finally, and most important, instead of promoting a genuine pluralism, incentives for large donations of capital property are apt to foster a kind of "philanthropic

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35 Duff, "Tax Treatment of Charitable Contributions in Canada," *supra* note 22.

36 *Ibid.*

37 As explained below, data reported in the Department of Finance study indicate that a much larger percentage of gifts of securities are made to educational institutions than is the case for other gifts. See *infra* note 49 and accompanying text.

38 See the argument at note 28, *supra*, and accompanying text.

39 See the argument at note 32, *supra*, and accompanying text.

40 See, for example, United States, Department of the Treasury, *Tax Reform for Fairness, Simplicity, and Economic Growth* (Washington, DC: Treasury Department, 1984), 72-74 (it is proposed that

paternalism” whereby 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. Indeed, as table 1 indicates, the percentage of aggregate charitable contributions claimed by donors with incomes exceeding \$250,000 increased significantly from 11.4 percent in 1996, before the introduction of special tax assistance for charitable donations of publicly traded securities, to 21.0 percent in 2000. While this shift in the distribution of charitable donations among different income groups is likely attributable to other reforms to the tax treatment of charitable contributions<sup>41</sup> as well as to the reduced capital gains inclusion rate for charitable donations of publicly traded securities, it is a worrying trend.

These concerns are not allayed by the Department of Finance study, which attempts to justify special tax assistance for charitable donations of publicly traded securities on three grounds: first, that the measure has proven to be “effective” in increasing donations; second, that these increased donations have been distributed “fairly” among charities; and third, that the additional incentive provides a combined level of tax assistance for donations of securities that is “roughly similar” to that in the United States. The remainder of this comment examines each of these claims.

Beginning with the conclusion that the measure has increased charitable donations, the study presents three kinds of data. First, it notes, “the value of publicly traded securities donated to eligible registered charities nearly tripled” between 1997 and 2000, increasing from \$69.1 million to \$200.3 million.<sup>42</sup> Second, “the number of donors of securities rose nearly five times” during this period, from 500 to almost 2,400.<sup>43</sup> Finally, “the growth in gifts of securities was much faster than the growth in total donations,” increasing by 190 percent between 1997 and 2000, compared with a growth rate of 18 percent for total gifts.<sup>44</sup>

In fact, of course, these figures neither establish that the reduced capital gains inclusion rate for gifts of publicly traded securities has increased charitable donations, nor demonstrate that any such increase, if it has occurred, is cost-effective in terms of forgone revenues. On the contrary, as the study itself acknowledges, it is impossible from these statistics to determine whether additional tax assistance for charitable donations of publicly traded securities has increased aggregate donations or resulted in a substitution from other kinds of donations to gifts of publicly

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the deduction for donations of property should be limited to the lesser of the property’s fair market value and its inflation-adjusted cost); Rabin, *supra* note 19, at 926; Andrews, *supra* note 14, at 372; and Goode, *supra* note 16, at 167-68.

41 Most significantly, the income-related ceiling on allowable charitable contributions was increased from 20 percent to 50 percent in 1996 and from 50 percent to 75 percent in 1997. For a brief discussion of these ceilings, see Duff, *supra* note 13, at 420-23.

42 *Tax Expenditures and Evaluations*, *supra* note 4, at 64.

43 *Ibid.*

44 *Ibid.* See also *ibid.*, table 2.

**TABLE 1 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

Source: Calculated from figures in Revenue Canada, *Income Statistics: 1996 Tax Year* (Ottawa: Supply and Services, 1998); and Canada Customs and Revenue Agency, "Interim Statistics-Universe Data: 2002 Edition (2000 Tax Year)," interim basic table 2, "All Returns by Total Income Class" (available online at <http://www.ccra-adrc.gc.ca/tax/individuals/stats/gb00/pst/interim/pdf/table2-e.pdf>).

traded securities.<sup>45</sup> Further, the study does not attempt to disaggregate the impact of the tax incentive from other influences on gifts of publicly traded securities, such as favourable financial markets between 1997 and 2000.<sup>46</sup> Nor does it attempt to weigh the resulting increase in charitable contributions against the estimated cost of the measure, which the Department of Finance estimates at \$15 million to \$73 million in terms of forgone federal tax revenues in 2000, depending on whether equivalent donations would have been made in the absence of the measure.<sup>47</sup>

With respect to the distribution of charitable donations of publicly traded securities among charities, the study again presents three kinds of data. First, it observes, while "large and medium-sized charities received a larger share of donations of securities than their share of total receipted gifts in 1997 (the only year for which detailed information on receipted gifts is available)," charities "of all sizes" received

45 Ibid., at 69: "[G]iven the short time period and the absence of data on donations of securities prior to 1997, it is difficult to assess the extent to which individuals who would otherwise have made cash donations may have switched to donations of listed securities."

46 Ibid.: "With available data and the relatively short time period the measure has been in place, it was not possible to isolate the influence of the half inclusion rate measure from that of other factors that may have affected donations of securities over 1997 to 2000. Strong economic conditions and positive financial market performances over this period may have stimulated more donations, and larger donations, than could be expected over an entire economic and market cycle."

47 Ibid., at 68. Assuming that equivalent donations would have been made in the absence of the measure, the estimated \$15 million cost represents a direct transfer to donors, providing no benefit to the charitable sector. Assuming that all donations of publicly traded securities are attributable to the additional tax incentive, the charitable sector would have received an additional \$200.3 million in 2000 at a cost to federal and provincial governments of approximately \$105 million. As the study acknowledges, actual costs and benefits are presumably "between these two ends of the spectrum." Ibid.

donations of publicly traded securities.<sup>48</sup> Second, although “the education sector’s share of donations of securities was far above its share of total receipted gifts,” charities “in all sectors” received donations of securities.<sup>49</sup> Third, while public foundations received a disproportionate share of donations of publicly traded securities, “[b]oth charitable organizations and public foundations received gifts of publicly traded securities over the four-year period” from 1997 to 2000.<sup>50</sup>

It is not clear what the study means by a “fair” distribution of donations of publicly traded securities among different kinds of charities. Although the data cited above suggest that all kinds of charities have received donations of publicly traded securities, they also demonstrate that these kinds of donations are directed disproportionately to large and medium-sized charities, educational institutions, and public foundations. Since these types of registered charities are favoured by more affluent donors, who are most likely to be the donors making gifts of publicly traded securities, these results are not surprising. To me, however, they are more suggestive of philanthropic paternalism than of a “fair” distribution of charitable donations among a diversity of organizations and activities.

The study’s final justification for the reduced capital gains inclusion rate for gifts of publicly traded shares is that this measure makes “overall tax assistance” for these donations “roughly similar to what is available in the United States,”<sup>51</sup> where gifts of publicly traded securities are exempt from capital gains tax but deductible at their fair market value. Assuming that gains on donations of publicly listed securities represent 60 percent of the securities’ value,<sup>52</sup> the study demonstrates that the combined effect of the charitable contributions tax credit and the reduced capital gains inclusion rate for charitable donations of publicly traded securities produces a level of tax assistance similar to that produced by the charitable contributions deduction and the non-taxation of gifts of publicly traded securities in the United States.<sup>53</sup> On this basis, the after-tax cost of these kinds of charitable donations would be similar in Canada and the United States.

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48 Ibid., at 64. See also *ibid.*, at 65, table 3.

49 Ibid., at 65. See also *ibid.*, table 4. According to these statistics, the education sector received 42.9 percent of gifts of publicly traded securities from 1997 to 2000, as compared with 15.8 percent of all receipted gifts in 1997. In contrast, gifts to religious organizations constituted 12.1 percent of donations of publicly traded securities between 1997 and 2000, as compared with 45.4 percent of all receipted gifts in 1997.

50 Ibid., at 66. See also *ibid.*, table 5. According to these figures, public foundations received 57.8 percent of gifts of publicly traded securities from 1997 to 2000, as compared with 15.0 percent of all receipted gifts in 1997. In contrast, gifts to charitable organizations constituted 42.2 percent of donations of publicly traded securities between 1997 and 2000, as compared with 85.0 percent of all receipted gifts in 1997.

51 Ibid., at 66.

52 The study provides no empirical basis for this assumption. According to the 1997 federal budget, *supra* note 7, at 113, however, US experience indicates that “the typical capital gain realized on the donation of appreciated capital property represents about 60 per cent of its value.”

53 *Tax Expenditures and Evaluations*, *supra* note 4, at 67, table 6.

Although certain segments of the charitable sector have lobbied for such similar tax treatment for many years,<sup>54</sup> it is not clear why Canadian tax policy should follow the much-criticized US approach.<sup>55</sup> On the contrary, while competitiveness concerns may drive other aspects of Canadian tax policy, differences between Canadian and US tax treatment of charitable contributions of publicly traded shares are unlikely to affect cross-border donations of these kinds of gifts.<sup>56</sup> Furthermore, as the study notes, other aspects of the tax rules in Canada and the United States make tax incentives for charitable contributions in Canada more generous than those in the United States.<sup>57</sup> Indeed, to the extent that there are fewer large donations of financial capital in Canada than in the United States, this is more likely to be caused by the charitable contributions deduction under the US estate and gift taxes, rather than differential treatment under each country's income tax.<sup>58</sup> As a result, if an increase in large charitable donations of financial capital is considered desirable, Canada would probably do better to restore taxes on the transfer of wealth than to reduce the capital gains inclusion rate on donations of publicly traded shares.<sup>59</sup>

## GENERAL CONCLUSIONS

By questioning the reduced capital gains inclusion rate on gifts of publicly traded securities and the justification for this measure advanced in the Department of Finance study, I do not mean to challenge the accuracy of the data presented by the department or the integrity of those who put the study together. On the contrary, the data are undoubtedly the best that are available in the circumstances, and the study itself acknowledges its limitations at several points. However, given what I consider to be the most persuasive rationale for special tax treatment of charitable contributions under the income tax, there are several reasons to question special tax assistance for charitable donations of publicly traded securities. The arguments and data presented in the Department of Finance study fail to allay these concerns.

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54 Even before the introduction of capital gains tax in 1972, representatives from private museums proposed that gifts of appreciated property should be non-taxable and deductible according to their fair market value, as in the United States. See R.M. Bird and M.W. Bucovetsky, *Canadian Tax Reform and Private Philanthropy*, Canadian Tax Paper no. 58 (Toronto: Canadian Tax Foundation, 1976), 24-25.

55 For criticisms of the US approach, see *supra* note 40 and accompanying text.

56 This is because the tax rules apply to residents of each country, irrespective of the destination of the charitable donation.

57 *Tax Expenditures and Evaluations*, *supra* note 4, at 67 (mentioning differences in annual income-related ceilings and a reduction in the charitable deduction in the United States where the donor's adjusted gross income exceeds US\$133,000).

58 See, for example, David Joulfaian, "Charitable Giving in Life and at Death," in William G. Gale, James R. Hines Jr., and Joel Slemrod, eds., *Rethinking Estate and Gift Taxation* (Washington, DC: Brookings Institution, 2001), 350-69, at 369 ("bequests seem to be the mode of transfers preferred by the very wealthy").

59 For an argument that Canada should restore taxes on the transfer of wealth, with an exemption for gifts and bequests to charitable organizations, see David G. Duff, "Taxing Inherited Wealth: A Philosophical Argument" (1993) vol. 6, no. 1 *The Canadian Journal of Law and Jurisprudence* 1-62.