
Backgrounder

Tax Incentives for Charities in Canada

The most recent tax data available show that Canadians donated more than \$3 billion to charities in 1992. Yet as the number of charitable organizations in this country continues to expand, so does the need for adequate funding. The federal government has traditionally promoted nonprofit activity through grants as well as in its fiscal policies. Federal tax incentives, encouraging charitable donations from citizens and corporations, are an effective means for the government to stimulate the work of charities.

Tax Incentives for Charities in Canada, by Kimberley Scharf, et al., is one of three new research papers commissioned by the Canadian Policy Research Networks (CPRN) with financial support from The Kahanoff Foundation's research initiative on the Nonprofit Sector. It addresses the economics of taxation as it applies to the charitable sector, and examines the challenge of designing a system that incorporates appropriate incentives for charitable giving.

Getting the Special Treatment

Organizations that qualify with Revenue Canada for registration as charities generally serve the public interest by working to relieve poverty, advance education or religion, and by serving other purposes beneficial to the community at large. Given the nature of their activities, these groups are eligible for special tax treatments not available to organizations operating to make a profit. For instance, registered charities are exempt from paying income tax. In addition, they can issue tax receipts to individual and corporate donors, who can then claim a tax credit.

Designing Tax Incentives to Encourage Giving

Ideally, the tax system in Canada would ensure that society's resources are put to their best use. Tax rules would be equitable and simple to follow and administer. These three objectives - efficiency, equity and simplicity - must guide the design of tax policy for charitable giving.

The Canadian tax system compares well with the best practices of other developed nations and, in recent years, the federal government has corrected some of the anomalies in the system. In its 1997 budget, the federal government improved the outlook for charities by allowing individuals a tax credit against a charitable donation of up to 75 percent of their annual income, up from the previous

limit of 50 percent. The application of this expanded income limitation was also extended equally to all charities, whether Crown agencies or other types of organizations. Despite these improvements, some issues remain regarding the design of existing tax incentives, especially when compared to U.S. policy.

A Credit System versus a Deduction System

The federal government gives individuals a tax credit against charitable donations. This system provides incentive to middle- and low-income earners making large donations. The United States allows individuals to deduct donations directly from their taxable income. Neither the Canadian nor the U.S. system creates an incentive for giving among low-income individuals who make small donations or among high-income earners who make large donations.

Tax Treatment of Capital Gains

Sometimes donors make gifts of capital property that have accrued capital gains or capital losses. However, Canadian donors are still subject to a federal tax on any capital gains, whereas in the United States, capital gains on appreciable property are exempt from taxation. Canada's 1997 federal budget permits 50 percent of taxable capital gains on donated property to be exempt from tax; only 37.5 percent of the capital gains on gifts of publicly traded securities are to be included in taxable income. These changes have given donors more tax relief, and may have an effect on whether a donor makes a decision to sell or donate appreciated property. However, it does create distortions that are not warranted among gifts of money, property and securities.

Political Credits

Under the current tax law, individuals who make small donations to political parties get greater tax relief than if they had made that same donation to a charity. All gifts, whether to charities or to political parties, should be treated on the same basis.

Goods and Services Tax (GST)

Recognizing the special situation of charities and other nonprofits, the government allows a partial rebate for the GST that is paid on purchases of goods and services. Under current rules, however, the amount of tax that is rebated differs according to the type of institution. For example, it is 50 percent for charities and 67 percent for universities and public colleges. GST credit relief for charities could be expanded to the level of that granted to other public service bodies.

The Municipal Tax Man

In Alberta, municipalities may now tax the property of nonprofit organizations. With ever-increasing budgetary pressure on local governments, other municipalities in Canada may soon start to target tax-exempt charities as an additional source of revenue. To thwart this movement, a reallocation of taxing powers may be called for and coordination will be required among federal, provincial and local governments.

Business Activities for Nonprofit Organizations

The Canadian tax system restricts nonprofit organizations from carrying on unrelated business activities. In contrast, the United States does not prohibit charities from pursuing business activities and earning profits; they are simply barred from distributing such profits as dividends. Allowing charities to conduct such business activities would provide them with additional sources of funds, reward entrepreneurship and innovation in the voluntary sector, and shield the government from excessive demands from charities.

Making Simplicity a Focus of Future Reforms

While the impact of our current tax system on charities is clear, new research is needed to determine the link between tax incentives and the behaviours of individual and corporate donors. Ultimately, any options for tax reform are difficult to assess in isolation, and must be evaluated within the overall framework of the broader tax system. In this respect, simplicity may be the most important consideration.

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