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THE CHARITIES PAPERS

Lending a Hand: How Federal Tax Policy Could Help Get More Cash to More Charities

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- Although total giving to charities in Canada has increased in the last two decades, the share of tax filers reporting cash donations has fallen, and the sector's reliance on large donations by wealthy donors has risen.
- This potentially stacks the deck against charities that rely on small cash donations.
- To broaden the donation base, the author suggests creating a single tax-credit rate for cash donations or an RRSP-like charitable gift plan.

Federal government policies support the work of Canadian charities and the people and organizations that donate to them. Ottawa does so directly through government grants to charities and indirectly through tax relief.[1] A marked trend in the pattern of charitable giving over the past 20 years, however, points to the need for reform of Ottawa's policy tools. The share of tax filers reporting donations has fallen and the sector's reliance on higher-income taxpayers for donations has increased. The result: a significant increase in large donations that stacks the tax playing field against charities that predominantly rely on smaller gifts. The purpose of this *e-brief* is to consider how best to reform federal tax policy to redress this balance and encourage greater cash donations.

Current Policies

Taxpayers can reduce their tax liability through their cash and non-cash donations to charities. In this e-brief, I focus on cash gifts and the non-refundable tax credits for those gifts.[2] For the first $200 of donations the federal income credit is 15 percent; above $200 the tax credit is 29 percent on donations valued at up to 75 percent of annual net income.[3] These credits reduce the cost, or price, of giving. If individuals are sensitive to the price of giving, the credits should increase donations, thereby benefiting charities.[4]

1 A third way the government can support charitable activities is through the provision of incentives for volunteering. For example, in some provinces high-school students must engage in community service in order to graduate. There are a few programs that encourage volunteerism by high-school and post-secondary education graduates. The research on the effects of these programs, however, is limited.

2 See Burrows (2009) for a discussion of tax relief for gifts of capital donations (e.g., securities and real estate).

3 Provinces provide similar credits to reduce the provincial tax liability that can result in the credits being higher than an individual's average tax rate.

4 See Andreoni (2006) for a discussion of individual motivations for giving.

While in theory tax credits can increase donations, there is mounting evidence that fewer people are using this tax advantage. Private giving has risen significantly, largely due to increases in donations by high-income and wealthy individuals. While this is good for many charities, tax policy that encourages donations of large gifts puts smaller charities at a relative tax disadvantage. Further, tax policy that makes charities reliant on a narrow base of wealthy donors leaves the sector (and needy recipients) vulnerable to economic fluctuations.

At the federal level, the most recent changes in tax policy have focused on increasing the tax advantages for non-cash donations; namely, donations of publicly traded securities. While this provision has increased donations, only a small share of charities have benefited from these changes. In 2007, less than 2 percent of all registered charities that filed an information return reported having received gifts of publicly traded securities.[5] Among charities ranked in the top 10 percent based on total reported revenues, close to 10 percent received donations of publicly traded instruments.[6] This suggests that most charities continue to rely heavily on cash donations and/or government grants for their support.

What do We Know about Giving in Canada?

When asked, a high proportion of Canadians consistently report donating money – on the order of 85 percent.[7] Moreover, the share of the population that reports these gifts varies positively with income. To benefit from tax credits, however, donations must be reported on one's tax return. In 2009, tax filers received credits for cash donations on the order of $2.2 billion.[8] How are these credits distributed across incomes and how have they changed over time? I use information from individual tax returns to examine how tax-reported giving has changed over the last decade. I grouped the information on donations from tax filers into three income groups based on the average income of the areas in which the tax filers reside (See Box 1 for details on calculation).[9]

Box 1: Information on Giving

Annual data on giving reported in this *e-brief* are from individual tax returns filed and the returns that registered charities are required to file. Statistics Canada provided aggregated information from tax returns for individuals that reside in urban and highly populated neighbourhoods as delineated by the first three characters of the postal code, known as a forward sortation area (FSA). I linked the data from the tax returns to neighborhood socio-economic characteristics from the Censuses. I group the FSAs into three groups based on the reported average family income for the 2001 Census. In 2001, the lowest and highest income neighbourhood groups represented between 2.9 and 3.0 million tax filers each; the middle-income group represented approximately 9.5 million tax filers. A downside to personal tax return data is that they underestimate giving because the only contributions reported are for the individual to gain a tax credit and households may combine their contributions. Informal giving (such as directly to a homeless person) or giving by low-income earners with no taxes to offset with a tax credit will not be reported.

5 Since 2003, the Canada Revenue information return asks charities to identify whether they have received donations of publicly traded securities and/or mutual funds.

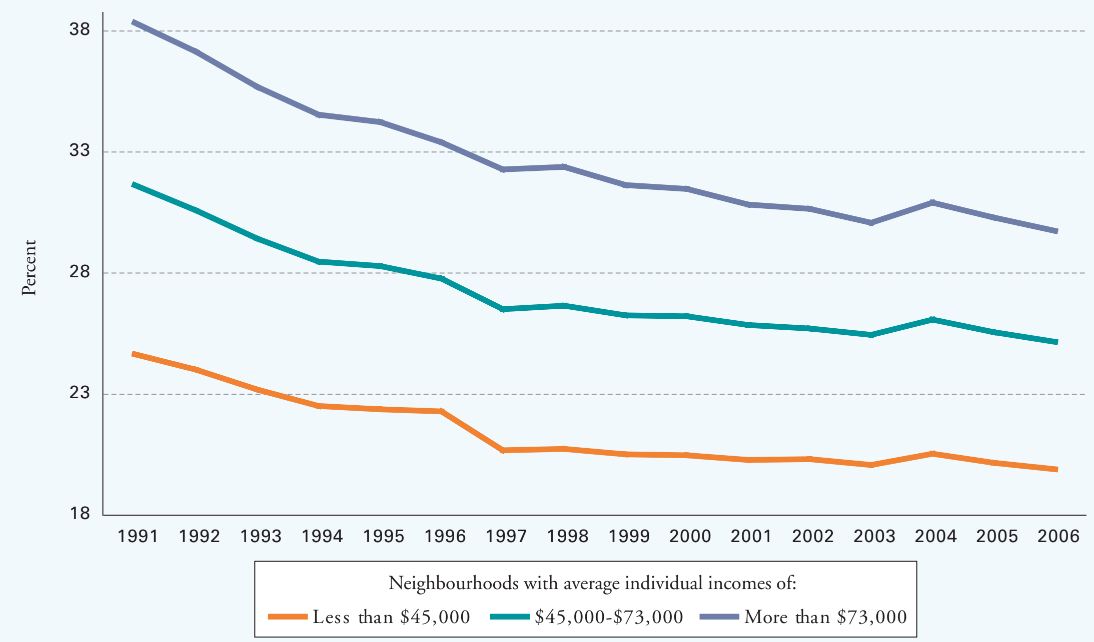
6 Ten percent of public foundations and 3.5 percent of private foundations reported receiving donations of publicly traded instruments.

7 These statistics come from the Canadian Survey of Giving, Volunteering and Participating.

8 This is estimated using Social Policy Simulation Database and Model (SPSM) 15.0 by comparing total federal government revenues under the scenario of no tax credit for cash giving versus total federal revenues with the current tax credit rates.

9 To ensure consistency in the reported neighbourhoods, we study only those areas for which data were provided for all of the years. Thus, the amounts depicted for each neighborhood grouping is representative for all taxpayers.

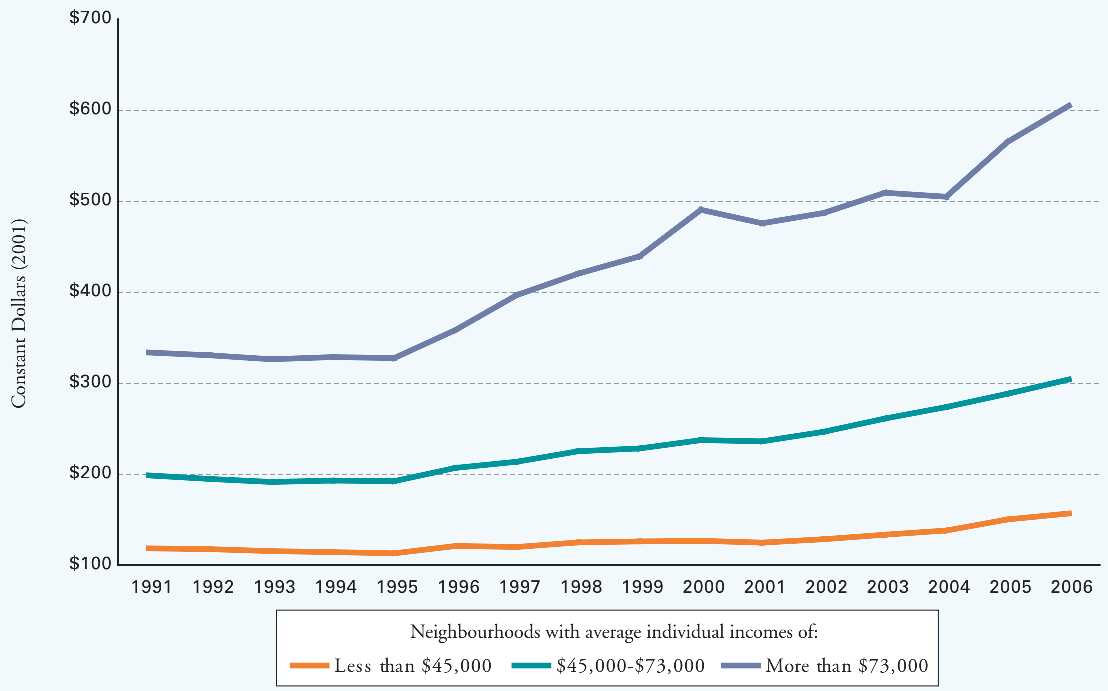
Figure 1: Share of Tax Filers Reporting Charitable Donations, by Neighbourhood Grouping



Note: All amounts are reported in 2001 dollars.

Source: Federal individual income tax returns aggregated at the Forward Sortation Area (see Box 1).

Figure 2: Average Giving Per Tax Filer, by Neighbourhood Grouping



Note: All amounts are reported in 2001 dollars.

Source: Federal individual income tax returns aggregated at the Forward Sortation Area (see Box 1).

While the share of tax filers reporting donations has declined (Figure 1), the average donation per tax filer has increased for all three groups (Figure 2). The growth in donations is most dramatic for the highest income group, which increased giving by more than 80 percent over the period. The increases for the middle and lower-income groups were approximately 50 percent and 30 percent, respectively. Although not depicted, total giving has increased in all three groups, especially for those in the highest income group (by more than 209 percent); part of this, however, is attributable to population growth.

These figures suggest an increasingly disproportionate share of the charitable giving is from tax filers residing in the higher-income neighbourhoods. These findings are potentially troublesome if the shift has resulted in charities relying on a smaller donation base for the bulk of their contributions.[10]

Can the Government Encourage Giving through Changes in Tax Policy?[11]

The effectiveness of tax credits depends on the ability of the credit to encourage greater giving by individuals, while balancing the administrative costs and tax revenue loss. Most researchers have found that individuals do not change their cash giving in response to existing tax savings and are normally motivated by the cause and/or solicitation (Duff 2004, Burrows 2009). In recent surveys, however, approximately 50 percent of donors indicate they would contribute more if given a better tax credit (see Hall et al 2009). Are there tax-policy changes the federal government can make to encourage greater giving? Below, I raise two possible changes.

A Single Tax Credit for Cash Gifts

The existing two-tiered tax credit results in an undervaluing of donations that are less than $200 and favors larger givers, who are often high-income individuals. A unified rate of 29 percent would simplify the administration of the credit. For taxpayers who donate more than $200, a switch to a unified rate would increase their tax credit no more than $28. Based on 2009 tax information, a switch to a uniform rate would reduce federal tax collections by approximately $110 million, or roughly 5 percent of the current credit that is provided. This reduction in tax collections, however, would increase if a uniform rate resulted in increased giving of small gifts by taxpayers.

A Higher Tax Credit for the First Dollar of Giving

A unified rate would simplify the credit, but it might not result in more giving, because it would only affect gifts of less than $200. If, however, we wanted to encourage giving by more individuals, including those with lower tax liabilities, we should question the reasoning behind offering a lower tax credit for the first dollar of giving than for the last. Would a higher credit for the first dollar of giving increase the base of givers? If so, is there a way to feasibly provide a higher tax credit on the first dollar of giving while minimizing the administrative burden for monitoring the gifts?

I propose a higher tax credit for the first portion of reported donations that would be tied to that taxpayer's income. This higher rate would be capped for high-income earners, because the goal is to increase the base of donors. Those with high incomes who donate to charity might be less affected by this type of proposal if their gifts exceeded the portion that would be eligible for the higher tax credit. The exact levels of the amounts eligible for the higher credit and the cap require further study.[12] To illustrate the proposal, imagine a provision with a higher tax credit for donations equal to 1 percent of a taxpayer's reported income up to a maximum reported donation of $500. A taxpayer with taxable income of $40,000 would receive the higher tax credit for donations

10 We looked at the reported revenues by registered charities on their information returns during the 1990s and 2000s (see Box 1). It appears that the level of giving varies dramatically across the charities based on their mission and the growth in giving has also varied across different mission types. The greatest growth in giving over the last decade was in the area of religious organizations, social services, and education. Growth in tax-receipted giving was somewhat flatter for arts and culture, health, and environmental.

11 An equally important question is whether government policy can encourage effective volunteering, however, we leave this issue for future work due to the currently limited evidence on the subject.

12 Also, the cost of providing an increased tax credit should be calculated. If one assumes a 40 percent credit up to a maximum donation of $500 and minimal changes in giving, the credit would reduce federal tax revenues by about $280 million.

up to $400 and would receive a credit of 29 percent for donations that exceed the $400 cap. Taxpayers with incomes of $50,000 or more would receive the higher tax credit for donations up to $500. For donations that exceed $500, the taxpayer would receive the higher credit on the first $500 and the existing 29 percent credit on the difference between the reported donations and $500.[13]

I also propose that the amounts eligible for a higher tax credit be allowed to accumulate. If an individual made no donations in one year, the amount eligible for the higher tax credit could be rolled over into the next year. Thus, tax incentives for giving would not be subject to short-term fluctuations in one's ability to give.[14] I suggest, however, that the number of years for which a potential tax credit could be accumulated be limited to five.

Is this proposed scheme feasible? To make it so, we propose linking the giving incentive to the information that is provided to taxpayers regarding their eligibility for Registered Retirement Savings Plan (RRSP) contributions. Each year, the Canada Revenue Agency sends taxpayers a notice that shows their previous year's contributions, and the calculation of any new contributions that may be made. I propose a similar scheme for sharing information with a taxpayer about the donations previously credited at the higher tax credit and the remaining amounts that are eligible for the higher credit on future tax returns. The higher credit on the first dollar of giving would encourage more individuals to donate to charity, potentially increasing the share of donors. Moreover, the annual statement on available credits would remind taxpayers of their existence and potentially encourage the non-donors to donate. If successful, charities would build a broader base of donations, which should help to reduce the potential deleterious effects from significant economic downturns. On the negative side, however, we would want to consider the extent to which a higher tax credit on the first dollar of giving might reduce gifts that are greater than the maximum amount eligible for the higher credit.[15]

Conclusions

Shifts in the pattern of charitable giving in Canada over the past two decades have highlighted the need for policy reform by Ottawa. While the share of tax filers reporting donations has fallen, the reliance on higher-income taxpayers for donations has increased, which poses challenges both for charities that rely on small donations, and those that rely on large donations.

A reliance on a narrower base of wealthy donors leaves charities vulnerable to even small changes in giving, such as that seen in the most recent stock market decline. If it is an express policy goal of the government to increase charitable giving by a broad base of donors, the existing tools are not achieving this goal. Burrows (2009) presents options for capital gifts, which would extend favorable tax treatment on capital donations to more types of assets. I suggest that this proposal can be complemented by creating a single tax credit rate for cash donations or an RRSP-like charitable gift plan.

13 While this would require the Canada Revenue Agency to calculate each taxpayer's higher tax credit limit, presumably the algorithm used to calculate one's RRSP maximum contribution could be adapted for this purpose.

14 For example, the taxpayer that earns $50,000 could effectively receive a higher tax credit of $500 for the year he or she did not report a donation in addition to any amounts eligible for the higher tax credit for the current year.

15 What if tax credits do not encourage greater giving to charity? An alternative to tax credits is the U.K. gift-aid system, which effectively transfers tax credits directly to the charity. The charity directly benefits from this scheme as it effectively creates a match between the private donation and the government transfer. Individuals in the higher tax brackets have the option of submitting a form that would allow them to receive tax relief based on their charitable donations. What is less clear, however, is the extent to which this system encourages greater private giving.

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