TAX REFORM IN CANADA: ARE ENHANCED AND TARGETED DONATION INCENTIVES HARMFUL FOR THE CHARITABLE SECTOR?

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Introduction

The 2013 Federal Budget introduced into Canadian law the new 'first time donor credit' (the 'FTDC'). The FTDC is a new tax concession with the express goal of attracting donations from a very specific category of taxpayer, namely, 'first-time donors'. My aim in this article is to utilise the adoption of the FTDC as a context to develop a straightforward, though perhaps controversial, point about donation tax incentives generally. I suggest that the design features of the FTDC have the potential to compromise one of the crucial policy goals of donation tax incentives, which is to preserve the independence of charities from government. My thesis proceeds from a normative view on the attributes and aims of the ideal donation incentive.

Tax expenditure analysis has long since supplied the widely, though not universally, accepted insight that donation incentives should be understood and evaluated from the vantage that they are the economic equivalent of direct state grants. On this view, donation incentives are appropriately regarded as an indirect state subsidy the defining purpose of which is to attract charitable donations by lowering the after-tax cost of donating to charity. Not surprisingly, the subsidy perspective results in the performance of donation incentives, and by extension the worthiness of reforms to donation incentives, being judged primarily on the basis of economic analyses of their effectiveness, specifically, their efficiency, at

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changing donor behaviour. At some level, this makes sense. It would be difficult to establish the policy irrelevance of efficiency considerations outside of arguing, as some have, that the income tax recognition of charitable donations can be understood as simply a way of properly measuring taxable 'income'.[1]

There is, though, an important metric other than efficiency to consider, or so I shall argue. The ideal donation incentive not only attracts charitable donations but does so without also attracting the same kind of governmental regulation of charities that would exist under a direct state grant. That is, the ideal donation incentive is the economic but not the regulatory equivalent of a direct state grant. The difficulty for policymakers is that these can be competing objectives.

To be sure, a donation incentive can be made to attract higher levels of charitable giving, and thus better achieve its fundamental purpose of subsidising charities, if the amount of the incentive (in Canada, the amount of the charitable tax credit) is enhanced. A government might, though, be concerned that an across-the-board enhancement of donation incentives would prove too costly to the public treasury and/or would introduce further inefficiency (because donors whose level of giving is unaffected by donation incentives could now benefit from an even larger tax credit). To address these concerns, the enhanced donation incentive could be targeted at only a specific category of taxpayers, perhaps those who will be most responsive to the enhanced incentive. The point I will develop in this paper with reference to the FTDC is that, even if reforming donation incentives such that they become more generous and/or more targeted might attract higher levels of charitable giving and/or achieve gains in the efficiency of donation incentives, such reforms might also tend to attract heightened regulatory interventions by governments into the affairs of charities. It is therefore not obvious to me that tax reforms such as the FTDC should be welcomed as viable ways of achieving the fundamental aims of donation incentives. If I am right, then there are plausible reasons to conclude that the best donation incentive is a comparatively modest incentive available to all taxpayers without distinction.

The FTDC and Canada's Recent Study of Donation Incentives

Canadian federal income tax law recognises charitable donations by individuals through a two-tier non-refundable charitable tax credit. The amount of the credit is 15 per cent for charitable donations up to $200 and 29 per cent for charitable

1 See e.g. W Andrews, 'Personal Deductions in an Ideal Income Tax' (1972) 86 Harvard Law Review 309.

donations beyond this amount.[2] The FTDC augments the charitable tax credit by an additional 25 per cent for eligible donations up to $1,000.00.[3] Before provincial tax credits are taken into account, this means that qualifying donations are eligible for a 40 per cent tax credit for donations up to $200 and 54 per cent credit for donations between $201-$1,000. Once provincial tax credits are taken into account, the combined tax credits can be as high as 50 per cent for donations up to $200 and 75 per cent for donations between $201-$1,000.[4] The FTDC is available for cash but not in-kind donations made after 20 March 2013 and before 1 January 2018.[5] The FTDC can only be claimed in a single taxation year regardless of whether the $1,000 maximum is claimed in that year.[6] To qualify as a first-time donor a taxpayer must be an individual (other than a trust) who has not claimed the charitable tax credit more recently than 2007.[7]

The FTDC brought what might be fairly described as an anti-climactic conclusion to a reform process that appeared to be on a trajectory toward more significant reform. The reform process originated in 2010 with private member's motion 559. This motion proposed that the Standing Committee on Finance 'undertake a study of the current tax incentives for charitable giving with a view to encouraging increased giving'. Whereas private members' motions typically fail to garner much support, motion 559 passed unanimously.[8] Predictably, the passage of motion 559 inspired a number of reform proposals that were advocated to the Standing Committee on Finance.[9] Two proposals, in particular, attracted the most attention. The first was to exempt donations of land and private securities from

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2 See Income Tax Act RSC 1985, c 1 (5th Supp) as amended (the 'Income Tax Act'), s 117(2) and 118.1(3).

3 ibid s 118.1(3.1).

4 These are the current combined federal and provincial credits in Alberta. The amounts vary from province to province.

5 Income Tax Act, s 118.1(3.1)

6 ibid ss 118.1(3.1) and (3.2). An individual and her spouse or common law partner can both claim the FTDC in any given taxation year. However, the cumulative donations claimed by the two taxpayers cannot exceed $1,000.

7 ibid s 118.1(1). An individual is disqualified as a first-time donor for any taxation year in which she is the spouse or common law partner of a person who has claimed charitable donations more recently than 2007.

8 Parliament of Canada, Federal Assembly, *Votings and Proceedings: Private Members' Business; Charitable Donations*, 40th Par, 3rd Sess, No 137 (2 March 2011) available at http://www.parl.gc.ca/HousePublications/Publication.aspx?Language=E&Mode=1&Parl=40&Ses=3&DocId=5001413#SOB-3774896

9 The reform briefs submitted to the Standing Committee are available at http://www.parl.gc.ca/HousePublications/Publication.aspx?DocId=5340612&Language=E&Mode=1&Parl=41&Ses=1

capital gains tax, neither of which currently qualifies for the exemption under paragraph 38(a.1) of the federal Income Tax Act for donations of publicly-listed securities. The second was the so-called 'stretch tax credit' which would have increased the charitable tax credit by 10 per cent for donations in excess of a taxpayer's previous highest level of charitable giving (with a proposed ceiling of $10,000).

The Standing Committee concluded in its 2013 final report - *Tax Incentives for Charitable Giving in Canada* - that the federal government should 'explore the feasibility and cost' of both reforms (among others).[10] The Standing Committee's support in principle for these reforms fueled anticipation that at least one or both of them might be adopted in the 2013 Federal Budget. The announcement of the FTDC instead came as a surprise, given that it was not among the recommendations made to or by the Standing Committee.

Predictable Responses to the FTDC

There are three predictable responses to the FTDC. The first - the cynical response - will attribute the FTDC to political considerations. The reform process appears to have left the government in something of a political muddle. The government evidently did not see the case for, or could not at this time justify the cost of, the particular reforms recommended to and endorsed by the Standing Committee. However, shelving the Standing Committee's final report might have proven politically problematic. Not only would this result in a lost opportunity for the government to build political capital by associating itself with the good works of charities, it would disappoint the very expectations the government had created within the charitable sector that donation incentives were going to be liberalised in some way or another. As a temporary and targeted tax measure, the FTDC presented a politically attractive, albeit minimalist, way for the government to keep faith with the charitable sector without committing itself to as significant a spending measure as either the stretch tax credit or the exemption of donations of land and private securities from capital gains tax.

The second response - the tax expenditure critique - will raise many of the familiar criticisms that have historically been levelled against tax expenditures generally. It will point out that the FTDC introduces further complexity to the law, violates the traditional tax norms of neutrality and horizontal equity and commits the government to a form of politically motivated and disguised spending for which

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10 The Standing Committee's recommendations appear on p 27 of its report, available at http://www.parl.gc.ca/content/hoc/Committee/411/FINA/Reports/RP5972482/finarp15/finarp15-e.pdf. The recommendations were qualified as being 'subject to the government's stated intention to balance the budget in the medium term'.

there will be little accountability. It will observe that the FTDC's horizontal inequity revives an old defect that previous reforms had remedied. One of the very reasons why the charitable gift deduction for individuals was replaced in 1988 with the charitable gift credit was to ensure that the income tax recognition of donations did not vary from taxpayer to taxpayer owing to the upside-down effect of deductibility. The FTDC is, however, deliberately designed to ensure that two taxpayers - taxpayer A and taxpayer B - earning the same income and donating the same amount to the same charity in a given tax year will be treated differently if A has in prior tax years donated faithfully and generously and B has traditionally preferred conspicuous consumption over charitable giving. The disparate treatment of these two taxpayers not only undermines horizontal equity but does so in a way that is inconsistent with the idea that donation incentives can be thought of as a reward for generosity.[11] The very criterion used to disqualify taxpayer A from the FTDC is her consistent pattern of generosity. One could very well question whether this supplies an appropriate basis for treating the two taxpayers unequally.

The third response - the economic response - will evaluate the FTDC from the perspective of its efficiency at attracting new donations. Economic analysis has long since represented the dominant methodology for the study of donation incentives. Economic analyses focus on whether donation incentives inefficiently reduce the after-tax cost of donations that would be made without the incentive. Recognising that at least a portion of total charitable giving is going to be inelastic, that is, unresponsive to donation incentives, the concept of treasury efficiency is used as a benchmark to determine when a tax concession is sufficiently efficient (or, if you will, not excessively inefficient).[12] It is based on the idea that the cost of a donation incentive in terms of foregone tax revenue should equal, or at least approximate, the amount of new charitable giving attracted by the incentive. Given the centrality of treasury efficiency to analyses of donation incentives, judgments formed of the FTDC will predictably be centred on (1) the accuracy of the government's cost estimates for the FTDC ($25 million for each of 2013-14 and 2014-15) and (2) the ratio of foregone tax revenue to new donations attracted by the FTDC. While I will leave such analysis to those versed in the methodology of empirical economic research, I will at least observe that the government's cost

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11 See e.g. Boris Bittker, 'Charitable Contributions: Tax Deductions or Matching Grants?' (1972-1973) 28 Tax Law Review 37, 60-61.

12 For a meta-analysis of the extensive published literature, see J Peloza and P Steel, 'The price elasticities of charitable contributions: A meta-analysis' (2005) 24(2) Journal of Public Policy and Marketing 260.

estimate of $25 million annually appears to correspond with only a small increase in cumulative charitable giving.[13]

All three of these perspectives have merit. Nevertheless, they all miss something fundamental to the evaluation of the FTDC specifically and to the evaluation of donation incentive reform generally. Policymakers have good reasons for wanting to understand whether donation incentive reform is likely to impact donor behaviour by inducing higher levels of charitable giving. What would be the point of enhancing incentives if levels of giving would more or less remain the same? I would suggest, however, that policymakers should also be concerned with the potential impact of donation incentive reform on governmental behaviour, specifically its impact upon the regulatory posture of the state vis-à-vis charities. In what follows I develop two points. The first is that donation incentive reforms concerned with enhancing and/or more specifically targeting the charitable tax credit at particular categories of taxpayers arguably carry with them the prospect of heightened regulatory scrutiny of charities. The second is that such a regulatory trajectory, should it occur (which I acknowledge is not a certainty), has the potential to undermine what I understand to be one of the crucial policy goals of the charitable tax credit, which is to subsidise charities while nonetheless preserving a certain separateness and independence of charities from government.

Donation Incentives and the Regulation of Charities

The FTDC modifies the charitable tax credit in two ways of potential relevance to the regulatory treatment of charities. The first is that it enhances the amount of the credit. The second is that, unlike the charitable tax credit, which has historically been available to all taxpayers without distinction, it restricts eligibility for the enhanced credit to a targeted class of taxpayers - first-time donors. In any analysis of how these two defining features of the FTDC might impact the regulatory treatment of charities, one must remain mindful that the FTDC is a modest and time-limited measure. It may well be, in fact very likely will be, the case that the FTDC expires as scheduled without any immediate or long-term regulatory impact. The FTDC is nonetheless significant from a regulatory perspective because it signals a certain receptiveness to reforms directed at making the charitable tax credit more generous, albeit on a more targeted basis. Since the

13 If the $25 million projected annual cost is calculated with reference to only the 25% FTDC, this projected cost corresponds with a modest annual increase in total donations of no more than $100 million. This number is, however, artificially high because it would be necessary to net out new donations that would have been made even without the FTDC. Further, the cost estimate presumably has to be based not just on the 25% FTDC but rather on the total cost of induced donations, meaning the costs arising from existing donation incentives augmented by the FTDC. Once this is done, the total increase in charitable giving is reduced considerably further.

ultimate legacy of the FTDC may prove to be the successor reforms it inspires, the analysis here is as much concerned, perhaps even more concerned, with future reforms modelled after the FTDC than with the FTDC itself. More specifically, it is focussed on how transitioning to an enhanced and formally targeted donation incentive might attract a different kind of regulatory environment for charities relative to a comparatively modest donation incentive generally available to all taxpayers without distinction.

The design features of donation incentives are not normally thought of as carrying with them regulatory implications for charities. However, the two are indeed linked in ways that are instructive to consider. The issue ultimately connecting the two is the familiar one of whether the income tax recognition of donation incentives is properly viewed as a normative income defining feature of tax law, as famously argued by William Andrews,[14] or as a tax expenditure, the far more widely held view.[15] Andrews' essential argument is that charitable donations are not 'income' and are outside of the normative tax base, because they are neither taxable consumption nor savings.[16] He draws on this insight to conclude that the income tax recognition of charitable donations is a structural income defining feature of tax law concerned not with subsidising charities but rather with the proper measurement of taxpaying capacity. In his words, the tax treatment of charitable gifts is a 'refinement in our notion of an ideal personal income tax, rather than a departure from it'.[17] If Andrews is correct that charitable donations are not 'income', it follows as a matter of income tax logic that they should not be subject to income tax. The tax expenditure perspective advances just the opposite position: since charitable donations qualify as taxable income, they should in the ordinary course be subject to income tax. The special tax treatment of charitable donations must therefore serve a purpose extrinsic to the basic goals of income tax, such as subsidising charities by reducing the after- tax cost of charitable giving.

While both the tax base and the tax expenditure views allow for regulatory interventions aimed at preserving and safeguarding the public trust inherent in

14 Andrews (n 1).

15 John Colombo describes the tax expenditure (or tax subsidy) view of donation incentives as being 'the most widely accepted rationale'; JD Colombo, 'The Marketing of Philanthropy and the Charitable Contributions Deduction: Integrating Theories for the Deduction and Tax Exemption' (Fall 2001) 36 Wake Forest Law Review 657, 682.

16 Andrews bases this argument on the contention that an ideal personal income tax would tax consumption on 'divisible, private goods and services whose consumption by one household precludes enjoyment by others' but exclude from the tax base consumption 'on collective goods whose enjoyment is nonpreclusive or the nonmaterial satisfactions that arise from making [charitable] contributions'; Andrews (n 1) 314-5.

17 ibid 312.

charitable subscriptions, they differ significantly in relation to at least four key regulatory issues. The first issue is whether regulatory interventions into the affairs of charities can be justified as a way of preserving the state's economic investment in charitable works. Whereas a subsidy view supplies a policy basis for such regulatory interventions, the tax base view frustrates this reasoning through its denial that there is any state subsidy at play here. The second issue is whether the definition of charity can be viewed as a mechanism for determining which institutions qualify for a state subsidy. Whereas a subsidy view might incline (and has indeed inclined) courts and regulators to define charity with a view to economising the state's subsidisation of charities,[18] the tax base view supports a conception of charity formally unaffected by tax revenue considerations. The third issue is whether (and to what extent) charity regulations should be developed on the basis that charities possess a public character.[19] Given its denial that charitable donations involve any element of state subsidy, the tax base view is consistent with the claim that charitable donations are an exclusively private (in the sense of non-governmental) source of funding for charities. In contrast, the subsidy view sees charitable donations as a mixed public-private source of funding for charities. While it does not automatically follow that charities should be regulated as though they are public institutions *per se*, the subsidy view nonetheless exposes an element of publicness that can be taken into account when developing charity regulation. The fourth issue is whether donation incentives should be subject to the same constitutional scrutiny as direct government expenditures. While it has been argued that the economic identicalness of direct and tax expenditures should result in them being treated identically for constitutional law purposes,[20] that argument is obviously frustrated by the tax base view that there is no form of state subsidy at play.

Given the very different regulatory postures fostered by the two views of donation incentives, it is relevant to determine which view will govern how the FTDC, or any like successor reforms, are received into Canadian law. Although the tax base view continues to attract pockets of support,[21] it is almost inconceivable that it will play a very meaningful role in any policy debates following from the enactment of

18 See e.g. *Amateur Youth Soccer Association v Canada Revenue Agency* [2007] SCJ No 42. The Supreme Court's use of tax expenditure reasoning in this decision is discussed in A Parachin, 'Legal Privilege as a Defining Characteristic of Charity' (2009) 48(1) Canadian Business Law Journal, 36.

19 See E Brody and J Tyler, 'How Public is Private Philanthropy? Separating Reality from Myth' (June 2009) The Philanthropy Roundtable, available at http://www.kauffman.org/uploadedFiles/how-public-is-private-philanthropy.pdf

20 See e.g. L Sugin, 'Tax Expenditure Analysis and Constitutional Decisions' (1998-1999) 50 Hastings LJ 407.

21 See e.g. JR Buckles, 'The Community Income Theory of the Charitable Contributions Deduction' (2005) 80(4) Indiana Law Journal 947.

the FTDC. The tax base view is vulnerable to numerous compelling critiques,[22] including what is perhaps the fatal criticism that the two-tier structure of Canada's charitable tax credit belies any suggestion that income measurement is the sole, or even primary, tax policy goal being pursued.[23] Given the shortcomings of the tax base view, it seems inevitable that the subsidy view will dictate the regulatory implications, if any, of the FTDC.

It might be helpful, then, to identify more specifically how a subsidy view of the charitable tax credit has to date played out in recent charity law debates. It is fair to say that the primary, if not singular, way in which a subsidy view of donation incentives is invoked in analyses of charity law is to rationalise constraints on charities, either in the form of governmental interventions into the affairs of charities or restrictive interpretations of the legal meaning of charity. In practically no regulatory context is the idea that charities benefit from a tax subsidy ever invoked other than to somehow justify or make sense of regulatory restrictions that might otherwise seem inappropriate. To cite a few recent examples, the subsidy view has been invoked to support the proposition that charities should be subject to legislated salary caps,[24] that charities should be regulated as effectively public rather than private institutions,[25] that courts should define charity with a view to the fiscal consequences following from an award of charitable status,[26] that charities should be subject to restrictions on political

22 For a review of the critiques, see A Parachin, 'Reforming the Meaning of 'Charitable Gift': The Case for an Alternative to Split Receipting' (2009) 57(4) Canadian Tax Journal, 787, 820-22.

23 The charitable tax credit is calculated using the *lowest* marginal tax rate of 15% for donations up to $200 and the *highest* marginal tax rate of 29% for donations in excess of $200 (see Income Tax Act, ss 117(2) and 118.1(3)). High income donors therefore pay more tax on the first $200 of charitable gifts than what they receive back in the form of a tax credit. The opposite holds true in relation to each dollar above $200 donated to charity by all donors not in the highest marginal tax bracket. For these donors, the tax credit doesn't operate simply to refund the tax paid on the income donated to charity but instead returns a surplus. The credit would not be structured in this manner if its sole purpose was to match income tax obligations with taxpaying capacity.

24 See the House of Commons debates over Bill C-470, which proposed what was in effect a cap of $250,000 on the compensation of any individual officer or employee of a charity. In particular, see *House of Commons Debates*, 028, 19 April 2010 at 1631(Hon Sukh Dhaliwal) at 1633 (Hon Andrew Kania) at 1632 (Hon Kelly Block) at 1634 (Hon Paul Szabo) and at 1635 (Hon Albina Guaranieri). See also *House of Commons Debates*, 009, 15 March 2010 at 420 (Hon Albina Guarnieri).

25 See Brody and Tyler (n 19).

26 n 18.

advocacy,[27] that religion should not qualify as charitable for purposes of tax law[28] and that charities should be subject to anti-discrimination requirements going beyond those applicable to non-governmental entities generally.[29] The list could go on.

We can sketch from this some potential regulatory implications of donation incentives being made more generous and more targeted. It seems unlikely that enhancing incentives could achieve anything but exacerbate to one degree or another whatever tendency already exists for a subsidy view of donation incentives to support interventionist approaches to regulating charities and fiscally driven approaches to constraining the meaning of charity. As the state subsidy for charities increases, it seems likely that legislators and regulators would see themselves as having an increased latitude, if not responsibility, to subject charities to new regulatory measures aimed at safeguarding, and perhaps increasingly controlling, the state's economic investment in charities. Further, as the fiscal dimension to legal charity becomes more pronounced, courts will presumably become increasingly willing to formally embrace a fiscal consequences test for charitable status, the likely result of which would be a more restrictive and less adaptable legal definition of charity. More generally, an increased public subsidy would bring a heightened tendency for charities to be viewed as public institutions, predisposing lawmakers to increasingly approach the governance and operation of charities as matters of public concern.

Likewise, transitioning to a more targeted donation incentive could also attract a new source of regulation for charities in the form of constitutional scrutiny. A still developing point of law is whether donation incentives specifically, and tax expenditures more generally, should be constitutionally scrutinised identically to direct expenditures. Such a development would mean that the state could not fund through tax expenditures activities that it is constitutionally prohibited from

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27 See e.g. *Human Life International in Canada v MNR* [1998] 3 CTC 126 (FCA) para 18. See also S Swann, 'Justifying the Ban on Politics in Charity' in A Dunn (ed), *The Voluntary Sector, the State and the Law* (Portland: Hart Publishing, 2000) 161, 166-67; A Dunn, 'Charity Law as a Political Option for the Poor' in C Mitchell and S Moody (eds), *Foundations of Charity* (Portland, Hart Publishing, 2000) 57, 75; P Luxton, 'Charitable Status and Political Purpose' (1995) NLJ Annual Charities Rev 24, 28; CEF Rickett, 'Charity and Politics' (1982) 10 NZUL Rev 169, 176; and UK., HC, 'Charities: A Framework for the Future' Cm 694 (1989) ch 2.

28 See N Brooks, 'The Tax Credit for Charitable Contributions: Giving Credit Where None is Due' in J Phillips, B Chapman and D Stevens (eds), *Between State and Market*: *Essays on Charities Law and Policy in Canada* (Kingston: McGill-Queen's University Press, 2001) 457, 480.

29 See e.g. N Mirkay, 'Losing Our Religion: Reevaluating the Section 501(c)(3) Exemption of Religious Organizations That Discriminate' (2009) 17 William and Mary Bill of Rights Journal 715.

directly carrying out or directly funding. Canadian courts have not squarely addressed the matter and U.S. cases have produced mixed results.[30] The argument has, however, been made many times, including with specific reference to tax concessions enjoyed by charities, that courts should view tax subsidies and direct subsidies as not only economic equivalents but also constitutional equivalents.[31] This perspective has the potential to significantly alter the regulatory landscape within which charities operate. Under this view, charities could be tax subsidised only where charitable programming was constitutionally scrutinised to determine its appropriateness for support from the state. The eligibility of religious institutions for charitable status would predictably face a constitutional challenge. In addition, charitable programming would become subject to a kind of constitutional scrutiny that is normally reserved for governmental programming. Among other things, this would possibly mean that the common law meaning of charity, which is used to determine eligibility for charitable status for income tax purposes, would be required to conform to constitutional law principles normally used to identify the limits of state action. Since the common law meaning of charity has the effect of defining the scope of permissible activities for charities, the effect would be similar to charities being directly subject to constitutional principles. The new found relevance to charities of, say, constitutionally protected equality rights could mean that the broad discretion currently enjoyed by charities to target programming at specific populations would become significantly restricted.

It is notable, however, that not all donation incentives are equally likely to attract constitutional scrutiny. Edward Zelinsky argues that, as a state subsidy becomes more targeted, it by definition becomes a 'more particularized, more intimate' form of state sponsorship.[32] This could matter from a constitutional perspective, or so it has been argued, because it makes it easier to link the state with the

30 See e.g. E Zelinsky, 'Are Tax 'Benefits' Constitutionally Equivalent To Direct Expenditures?' (1998) 112 Harvard Law Review 379, 380-1.

31 See e.g. Sugin (n 20); R Clarke Brown, 'State Action Analysis of Tax Expenditures' (1976) 11 Harv CR-CLL Rev 97; Note, 'The Judicial Role in Attacking Racial Discrimination in Tax-Exempt Private Schools' (1979-1980) 93 Harvard Law Review 379; P McDaniel, 'Federal Matching Grants for Charitable Contributions: A Substitute for the Income Tax Deduction' (1971-1972) 27 Tax L Rev 377; S Surrey, 'Federal Income Tax Reform: The Varied Approaches Necessary to Replace Tax Expenditures with Direct Governmental Assistance' (1970) Harvard Law Review 352; S Surrey, 'Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures' (1970) 83 Harvard Law Review 705; D Adler, 'The Internal Revenue Code, The Constitution, and The Courts: The Use of Tax Expenditure in Judicial Decision Making' (1993) 28 Wake Forest L Rev 855.

32 Zelinsky (n 30) 410-11.

activities of the institution being subsidised than would otherwise be the case.[33] It is for this reason that a targeted donation incentive might attract constitutional scrutiny that would otherwise not exist under a donation incentive formally available to all taxpayers without distinction. The analysis is necessarily contextual. Just as not every enhancement in the amount of the charitable tax credit would necessarily yield corresponding regulatory enhancements for charities, neither would every effort at targeting the credit necessarily attract constitutional scrutiny. My goal here is therefore not to make dogmatic predictions of what specific regulatory reforms would necessarily follow from enhancing and/or more specifically targeting the charitable tax credit but rather to identify the trajectory of regulatory reform that this might have a tendency to yield. There are plausible reasons to suggest that such reforms, if they yield any regulatory effect at all, would tend towards augmenting existing regulations.

I turn next to consider whether such a development would remedy a regulatory void or undermine any of the charitable tax credit's crucial policy objectives.

The Policy Goals of Donation Incentives

The appeal of an enhanced and targeted donation incentive to policymakers is certainly understandable. Assuming, as the empirical studies suggest we can,[34] that the demand for charitable giving is not price inelastic, enhancing donation incentives is one way to achieve the ultimate policy goal of attracting charitable donations. Further, those who view efficiency as an essential characteristic of a 'good' donation incentive will have reason to prefer a targeted incentive over a uniform incentive available to all taxpayers without distinction. Unlike the latter, the former allows policymakers to contain costs and reduce inefficiency by attracting donations from specific taxpayers, for example, those most responsive to donation incentives or those for whom existing incentives are insufficient to alter behaviour. We might also conclude that an enhanced and targeted donation incentive is in some respects consistent with the theoretical thinking behind donation incentives. The extensive body of scholarship dealing with donation incentives has identified a number of reasons why a tax subsidy for charities in the form of a donation incentive is preferable to a direct subsidy. The arguments include the claims that a donation incentive fosters a form of direct democracy unavailable under a direct subsidy by enabling donors to vote (through donations) how tax dollars are spent,[35] better allocates the costs of charitable programming

33 ibid.

34 See Peloza and Steel (n 12).

35 S Levmore, 'Taxes as Ballots' (1998) 65 University of Chicago Law Review 387.

between taxpayers generally and individual donors who value that programming[36] and offers efficiency advantages, at least inasmuch as they are treasury efficient.[37] If this were all there were to it, then it could be said that an enhanced incentive aimed specifically at donors who are not currently making charitable contributions would help achieve all of the policy goals behind the charitable tax credit, provided at least that it was effective at inducing donations from its target demographic.

There are, however, other metrics to consider, including the extent to which donation incentive reform would impact the regulatory treatment of charities. We might conclude that one of the charitable tax credit's critical policy objectives will have been frustrated if, as I suggested above, the FTDC, or any successor reforms that the FTDC inspires, prompts regulatory reforms compromising the separateness and independence of charities from government. Interestingly, the relative lack of government control and oversight over charities has been criticised as an incurable defect of the charitable tax credit of sufficient concern to warrant its repeal.[38] However, this criticism may well miss the point. The goal of donation incentives is not merely to attract donations but rather to attract donations without attracting the same kind of government control and oversight that would typically exist under either a direct subsidy or a government supplied good or service. A recurring theme in the academic literature dealing with charity tax concessions is that charities are, and should remain, 'separate from government'.[39] A donation incentive has been said to be superior to a direct state grant in the sense that it represents the funding mechanism most respectful of the separateness of charities from government - in that it 'lessens the involvement of government in the affairs of charities'.[40] Likewise, a tax subsidy has been rationalised on the basis that it 'carries with it a sense of leaving the nonprofit sector inviolate'.[41]

36 M Gergen, 'The Case for a Charitable Contributions Deductions' (1988) 74 Virginia Law Review 1393, 1399-1406.

37 See e.g. W Vickrey, 'One Economist's View of Philanthropy' in FG Dickinson (ed), *Philanthropy and Public Policy* (New York: National Bureau of Economic Research, 1962) 31; M Feldstein, 'The Income Tax and Charitable Contributions' (1975) 28 National Tax Journal 81; Gergen (n 36) 1404; P Wiedenbeck, 'Charitable Contributions: A Policy Perspective' (1985) 50(1) Missouri Law Review 85; and D Duff, 'Tax Treatment of Charitable Contributions in Canada: Theory, Practice, and Reform' (2004) 42 Osgoode Hall Law Journal 47, 59-61.

38 Brooks (n 28).

39 D Brennen, 'Charities and the Constitution: Evaluating the Role of Constitutional Principles in Determining the Scope of Tax Law's Public Policy Limitation for Charities' (2002) 5(9) Florida Tax Review 779, 847.

40 ibid 845.

41 E Brody, 'Of Sovereignty and Subsidy Conceptualizing the Charity Tax Exemption' (1998) 23 Journal of Corporation Law, 585, 588.

According to this reasoning, a permanent tax concession available to all institutions meeting stable eligibility criteria not only removes charities from the annual process of petitioning the state for subvention but 'keeps government out of the charities' day-to-day business'.[42]

To be clear, the claim is not that a tax subsidy immunises charities from any form of state oversight. A tax subsidy will inevitably tend to bring with it some degree of state regulation aimed at preserving and protecting the public funding implicit in donation incentives. At the minimum, this is apt to include regulations ensuring that official donation receipts can only be issued for qualifying contributions,[43] that donations are properly valued,[44] that private inurement is restricted[45] and, that abusive donation types are excluded from the tax expenditure program.[46] It can even include selective interventions into the internal management of charities by, for example, prohibiting charities from being operated for political purposes.[47] The argument that a tax subsidy is somehow protective of the independence of charities does not ignore the inevitability of such state regulation. It merely posits that, compared to a direct state grant, a tax subsidy is apt to attract a muted and less vigorous form of state oversight.

The suggestion that diminished government control is a desirable feature of the charitable tax credit worth preserving runs the risk of being written off as libertarian politics masquerading as scholarly analysis. However, there is greater substance to the point than what such a retort acknowledges. Since the goal of the charitable tax credit is to attract donations to particular institutions - those

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42 ibid 586. Though Brody makes this point with specific reference to the tax exempt status of charities, I do not understand her argument to preclude the identical reasoning from being applied to donation incentives.

43 A contribution to a charity must qualify as a 'gift' (Income Tax Act, para. 38(a1), s 110.1(1) and 118.1(3)). Income Tax Act, s 248(30) of elaborates on the requirements of a 'gift'. There is also an extensive body of case law and CRA regulatory publications dealing with the pre-requisites of gifts.

44 Receipts can only be issued for the 'eligible amount' of gifts, which is defined in Income Tax Act, s 248(31). In addition, there are valuation rules specific to certain kinds of donations, e.g., s 248(35).

45 See e.g. the definitions of 'charitable foundation' and 'charitable organization' in Income Tax Act, s 149.1(1). In addition, ss 149.1(2)(c), (3)(b.1) and (4)(b.1) prohibit gifts by charities to non-qualified donees and s 88.1(4) provides a penalty applicable where a charity confers an 'undue benefit' on any person.

46 There are various anti-avoidance measures enacted to respond to abusive donation types. See e.g. Income Tax Act, s 46(5), which denies favourable capital gains tax treatment to art flips, s 118.1(13), which provides for the non-recognition of gifts of non-qualifying securities and s 248(32)(b), which is meant to frustrate abusive leveraged donations.

47 See e.g. Income Tax Act, s 149.1(6.1) and (6.2) and the authorities cited in n 27.

qualifying as charitable at common law - its design should arguably be attentive to the preconditions for charitable status at common law. It is notable then that, although a blurring of charitable and governmental pursuits has occurred through time, the authorities continue to contemplate the separateness of charity from government. So, for example, donations to governmental departments for their general purposes and trusts for the purpose of carrying out governmental policy have been held not to qualify as charitable.[48] Also, the Charity Commission for England and Wales, whose policy documents are regarded as authoritative throughout the Commonwealth, observes that charitable trusts must be independent from government.[49] In the view of the Commission, if the purpose of a trust is ultimately to implement the policies of government, or if the trust operates such that it merely carries out the directions of government, then it will not qualify as charitable. The best explanation for this is that charities are not government and cannot be operated or established as an arm of, or under the immediate control of, government. We can think of the charitable tax credit as a funding mechanism that respects this characteristic of legal charity. The diminished government control relative to a direct subsidy is therefore arguably not an accidental defect but rather a concession to the unique nature of charitable trusts. This is not to suggest that direct state funding is inherently incompatible with the pre-requisites for charitable status. It is merely to say that there is a principled basis for viewing the relative lack of government control under a tax subsidy as something worth preserving.

Likewise, we find in the rationales for subsidising charities through tax concessions a basis for embracing diminished state control as a virtue of the charitable tax credit. In addition to the rationales mentioned above, another commonly accepted rationale is that charitable programming offers comparative advantages over government programming in the sense of greater pluralism, innovation, quality and diversity.[50] If these advantages are illusory, as has been argued to be the case,[51] then perhaps it is time to re-evaluate the case for the continued existence of the charitable tax credit. But if the comparative advantages are real, then the charitable tax credit should be designed with a view to fostering the kind of regulatory infrastructure within which those comparative advantages are most likely to flourish. It would be self-defeating to adopt a tax concession

48 See M Harding, 'Distinguishing Government from Charity in Australian Law' Sydney Law Review 31 (2009) 559, 561-63.

49 Charity Commission for England and Wales, *RR7 - The Independence of Charities from the State* (February 2001).

50 See e.g. Duff (n 37) 62, Bittker (n 11), 61-62, Levmore (n 35) 411, B Weisbrod, 'Toward a Theory of the Voluntary Non-Profit Sector in a Three-Sector Economy' in E Phelps (ed), *Altruism, Morality, and Economic Theory* (New York: Russell Sage Foundation, 1975) 171.

51 Brooks (n 28).

whose ultimate effect was to erode the very characteristics that qualify charities as suitable candidates for a state subsidy in the first place. It seems at least plausible to suggest that this is exactly what could occur if the design features of a tax concession have a tendency to attract reforms resulting in charities being regulated, through constitutional law or otherwise, and controlled as extensions of government. The more that charities are regulated and controlled by government, especially in relation to matters of program delivery, the more they will presumably resemble offshoots of government and the less they will presumably offer comparative advantages over government. So if the goal of the charitable tax credit is to enable the comparative advantages of charities over government, we find in that goal at least one tenable reason to preserve some degree of separateness of charities from government.

The argument made out here is vulnerable to the critique that governments not only fund charities through tax subsidies but also through direct state grants. In fact, direct state grants represent the principal source of funding for many charities.[52] One might say then that it is redundant to insist that donation incentives be designed with a view to insulating charities from the very kind of government control and oversight to which they are already subject by virtue of receiving direct state grants. However, the fact that some charities receive direct subsidies does not render the argument set out here moot. Since not all charities are offered, or choose to accept, direct subsidies, not all charities are currently subject to the kind of control and oversight accompanying direct grants.[53] More importantly, even in contexts where direct state grants are common, the scope and form of governmental control and oversight can be tailored to context-specific policy concerns. In contrast, regulations inspired by an overly generous and overly targeted donation incentive would likely apply indiscriminately to all charities as a pre-condition for being able to issue official donation receipts.[54] The regulation of legal charity should, however, be more respectful than this of the sheer breadth and diversity of charitable pursuits. To say that there is value in preserving the separateness of charities from government is not to deny that some

52 Statistics Canada reports that government transfers (exclusive of goods and services provided by charities under contract with government) account for approximately three quarters of the total income for hospitals, universities and colleges. See the Satellite Account of Non-Profit Institutions and Volunteering available at http://www.statcan.gc.ca/nea-cen/list-liste/npiv-nblb-eng.htm

53 Churches, for example, rely primarily upon private donations for funding.

54 Although the Income Tax Act sets private foundations apart from other charities for unique regulatory treatment, it does not otherwise distinguish between charities, at least not on the basis of the four categories of legal charity: the relief of poverty, the advancement of education, the advancement of religion and other purposes of public benefit. Income tax law, at least as currently constituted, is therefore something of a blunt instrument for regulating charities.

charitable purposes, for example, health care, should attract a greater degree of governmental control and oversight relative to others; for example, religion. It is merely to raise questions about reforming donation incentives in ways that could attract regulatory interventions similar to those fostered by a direct state grant. A defensible way to acknowledge the disparate regulatory concerns raised across the various categories of legal charity is to continue the long-standing practice of funding charities in two distinct ways: (1) through donation incentives that are deliberately designed to preserve as much as possible the separateness of charities from government; and (2) through direct state grants that are delivered to select charities and that attract enhanced accountability to government as appropriate to the context.

Conclusion

Tax reforms directed at enhancing and more specifically targeting the charitable tax credit have the potential to increase overall levels of charitable giving but at the risk of also attracting enhanced regulatory scrutiny of charities. Some charity managers might readily accept that a potential erosion of autonomy is a worthwhile price to pay for enhanced levels of charitable giving. I am sceptical. Revenue generation is not the only policy goal of donation incentives. The policy choice to fund charities through donation incentives, as opposed to, say, direct state grants, reflects the judgment that the comparative advantages of charitable programming are best fostered when charities remain more separate from government than they would under a system of direct state grants. It is, for this reason, imperative to consider the regulatory impact, if any, that could follow from reforming donation incentives.

There is admittedly no bright line test for identifying precisely when a donation incentive should from this vantage be judged as overly generous and/or overly targeted. Neither is there a way to design a donation incentive such that it is incapable of attracting state regulatory intervention. Indeed, relative to no donation incentive at all, even an extremely modest incentive available to all taxpayers without distinction exposes charities to a heightened prospect of state regulation. Designing the ideal donation incentive is therefore not a science resting on hard empirical evidence but rather a craft drawing upon judgment and reasoned reflection. I doubt that Canada's five year experiment with the FTDC will in and of itself bode long term regulatory consequences for charities. Should the FTDC leave a legacy, it will be the future reform discussions it inspires. My goal in this article has been to guide those discussions by highlighting that the various design options for donation incentives carry with them not just disparate funding implications for charities but also disparate regulatory implications. We should be as much concerned with the impact of donation incentive reform on governmental behaviour vis-à-vis charities as on donor behaviour.