



OFFICE OF THE
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Cost Estimate of Bill C-239: An Act to amend the Income Tax Act (Charitable Gifts)

Ottawa, Canada
31 May 2016
www.pbo-dpb.gc.ca

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Section 79.2(d) of the *Parliament of Canada Act* allows parliamentarians to request the Parliamentary Budget Officer to cost any issue under the jurisdiction of Parliament. Pursuant to a request under this statute from Mr. Pierre-Luc Dusseault, Member of Parliament for Sherbrooke, this note provides a cost estimate of Bill C-239: *An Act to Amend the Income Tax Act (Charitable Benefits)*.

This report was prepared by the staff of the Parliamentary Budget Officer. Jason Jacques wrote the report. Chris Matier, Mark Mahabir and Mostafa Askari provided comments. Patricia Brown and Jocelyne Scrim assisted with the preparation of the report for publication. Please contact dpb@parl.gc.ca for further information.

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Executive Summary

This report, requested by Mr. Pierre-Luc Dusseault, Member of Parliament for Sherbrooke, provides a cost estimate of Bill C-239: *An Act to Amend the Income Tax Act (Charitable Benefits)*.

The Government's current framework for charitable tax credits provides that individuals be permitted to deduct from their federal tax payable for a taxation year:

- 15 per cent on the first \$200 of donations;
- 29 per cent on all subsequent donations above \$200; and,
- 33 per cent on the portion of donations made from income that is subject to that tax rate (that is, individuals paying tax on income above \$200,000).

In 2013, the most recent year for which official federal tax data are available, 5.76 million taxpayers claimed about \$9.3 billion in monetary charitable donations on their tax returns. This cost the Government \$2.3 billion in forgone tax revenues.

Bill C-239 proposes to replace the current monetary charitable contributions regime with a new framework for individuals. The new rate structure would enrich the existing federal incentives and provide that monetary gifts to registered charities made by individuals:

1. up to the first \$400 would receive a 75 per cent tax credit;
2. for the subsequent \$350 would receive a tax credit of 50 per cent; and,
3. all amounts above \$750 would receive a tax credit of 33⅓ per cent.

As well, the amount of the total donations to registered charities eligible for the proposed credit would not be capped at 75 per cent of the annual net income of the donor.

Overall, if C-239 were implemented, it would cost the Government roughly \$1.7 billion more in 2016, rising to \$1.9 billion in 2020 (Summary Figure 1). This would bring the total annual cost of the credit to about \$4.2 billion in 2016, an increase of about 68%.

The additional cost is attributable to two factors. First is the primary fiscal cost, which is the change in the value of the charitable tax credit that would arise from the existing composition of taxpayer claims (that is, assuming taxpayer behaviour is unchanged). The second reflects the behavioural impacts attributable to people choosing to donate more money to charities because of a more generous tax credit rates.

Summary Figure 1 Overall fiscal cost of Bill C-239

	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>
	Fiscal cost (\$ millions)				
<i>low</i>	1,505	1,555	1,608	1,662	1,718
<i>mid-point</i>	1,678	1,735	1,793	1,854	1,916
<i>high</i>	1,852	1,915	1,979	2,046	2,114

Sources: Social Policy Simulation Model and Database, Version 22.1; Bill C-239; and Parliamentary Budget Officer.

Note: The estimated fiscal cost for 2016 is grown at the annual average growth rate for Finance Canada's actual and projected cost estimate for the current cost of the federal tax credit for monetary charitable donations between 2010 and 2015. The percentage change in the after-tax cost of giving includes existing provincial charitable tax credits.

1. The Current Framework for the Charitable Tax Credit

What is a tax credit?

Tax credits are amounts that can be used to offset an existing federal tax liability. Most federal tax credits for individuals are calculated by multiplying the tax rate of the first income tax bracket (15%) by the relevant statutory amount or expenditure. For example, a transit pass that cost an individual \$800 would result in a \$120 tax credit.

The Government currently provides a non-refundable tax credit to individuals for their monetary charitable donations.¹ According to the Government's Tax Expenditures Report, the purpose of this tax expenditure is "...to support the important work of the charitable sector in meeting the needs of Canadians".²

The Government's current framework for charitable tax credits is expected to be amended in the near future through Bill C-2. As such, for the purposes of this analysis, PBO assumes the measures in Bill C-2 to be the "status quo". Specifically: individuals will be permitted to deduct from their federal tax payable for a taxation year:

- 15 per cent on the first \$200 of donations;
- 29 per cent on all subsequent donations above \$200; and,
- 33 per cent on the portion of donations made from income that is subject to that tax rate (that is, individuals paying tax on income above \$200,000).

The current tax credit also has several other important features salient for financial analysis. First, eligible charitable donations may be pooled between spouses and claimed on a single tax return. As well, eligible donations can be carried forward up to five years, or carried backward up to one year in the case of a deceased taxpayer.

Finally, taxpayers are able to claim a charitable tax credit of up to 75 per cent of their total net income in a given year. Box 1-1 provides an example of how the framework for the federal charitable tax credit applies using practical examples.

Provincial and territorial governments also offer additive non-refundable tax credits for monetary gifts to charities.

Box 1-1 How the charitable tax credit works

Example #1:

Bob is a single male with taxable income of \$100,000. He made \$250 in monetary donations to eligible charities over the past year.

On his next tax return, Bob would be able to claim a non-refundable federal charitable tax credit of \$44.50: 15 per cent of the first \$200, plus 29 per cent of the subsequent \$50.

Example #2:

Christine and Phil have been married for over 30 years and both work outside the home, with taxable incomes of \$220,000 and \$35,000, respectively. Beyond regular volunteer work, both spouses donate to various charities each year. Last year, they each made \$400 of eligible monetary contributions to eligible charities.

On their next tax returns, Christine and Phil would be able to pool their monetary contributions on a single return. As well, given that Christine has paid federal tax of roughly \$6,600 at the 33 per cent rate, claiming all \$800 of donations on her return would provide a federal charitable tax credit of \$228: 15 per cent of the first \$200, plus 33 per cent of the subsequent \$600.

Example #3:

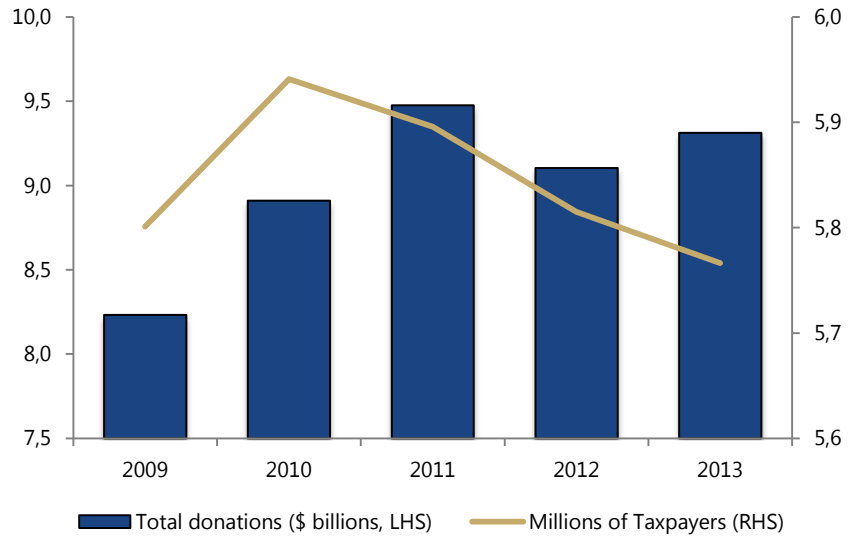
Charles is a single male with an annual taxable income of \$18,000. Over the past five years, he has made cumulative monetary donations to eligible charities of \$500.

By pooling these donations and claiming them in a single year, Charles would be able to claim a non-refundable federal credit of \$117: \$30 on the first \$200, and \$87 on the subsequent \$300.

In 2013, the most recent year for which official federal tax data are available, 5.76 million taxpayers claimed about \$9.3 billion in monetary charitable donations on their tax returns (Figure 1-1).

Figure 1-1

Fewer charitable donors claiming more tax credits

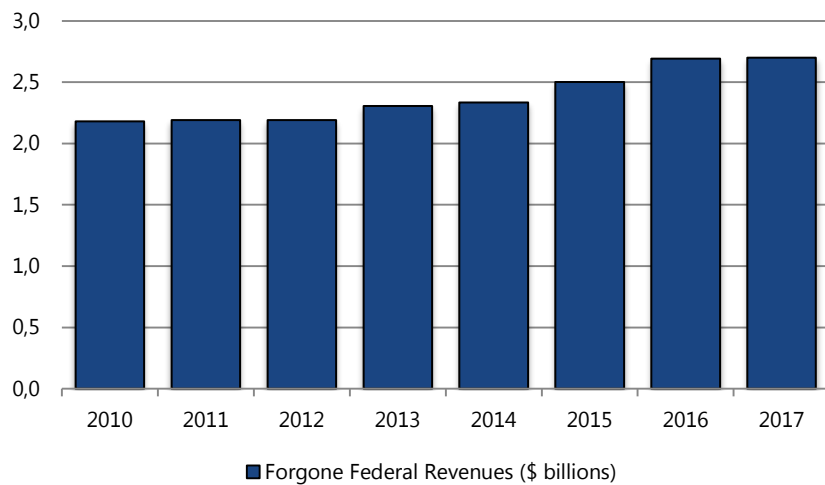


Source: Canada Revenue Agency Tax Statistics.

Commensurate with the growth in total charitable donations claimed by taxpayers, the cost of this tax expenditure has also grown; in 2013, it reached \$2.3 billion (Figure 1-2). The Government projects that the cost of the current tax credit will grow to over \$2.5 billion by 2017. This implicitly means that roughly 25 per cent of all donations, or one in every four dollars contributed, were indirectly funded by the Government.³

Figure 1-2

Government projects cost of charitable tax credit to exceed \$2.5 billion in 2017



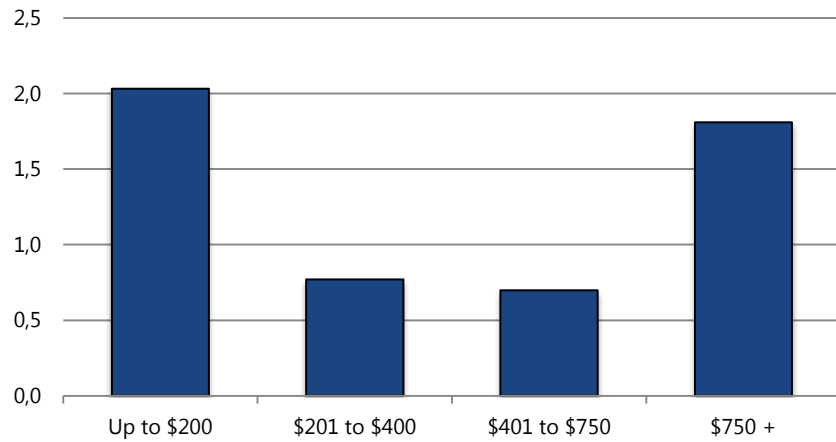
Source: Report on Federal Tax Expenditures 2016.

Based on analysis prepared using Statistics Canada's Social Policy Simulation Database and Model for the 2016 tax year, the average charitable donation claimed by all tax filers is about \$320. However, most donations are either under \$200, or above \$750, with few tax filers claiming close to the average amount.

Figure 1-3

Most charitable tax credit claims are under \$200 or over \$750, 2016 tax year

Millions of charitable tax credit claims



Source: Social Policy Simulation Model and Database, Version 22.1.

Note: Data from the Social Policy Simulation Database are representative of the distribution presented in actual tax administrative data, but do not match precisely.

What is a decile?

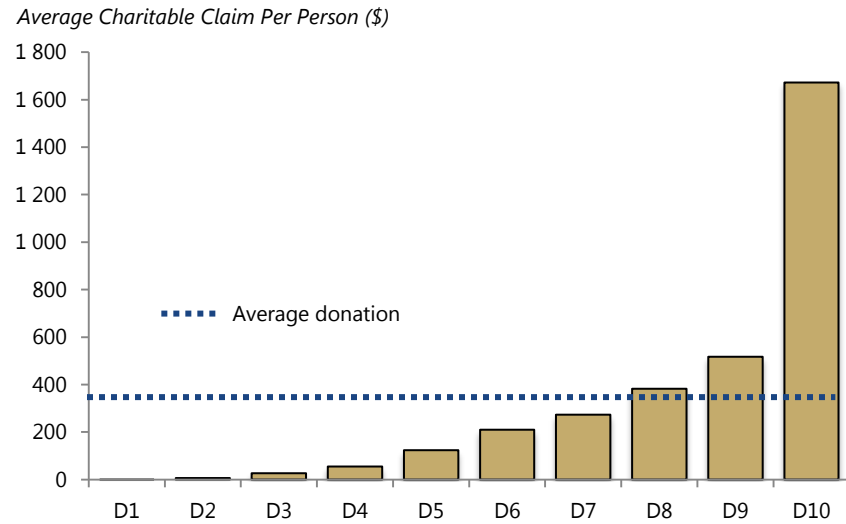
A decile is 10% of a ranked/ordered group that is being analysed. In this situation, all tax filers were ranked/order into 10 equal groups from lowest to highest taxable incomes.

Tax filers with higher taxable income are responsible for a disproportionate amount of charitable tax credit claims (Figure 1-4). Tax filers reporting less than \$41,000 of taxable income (that is, up to and including the first six deciles) claim far less than the average, while those in the highest income decile claim over six times the average.

Overall, over half of all monetary charitable donations claimed on federal tax returns are attributable to tax filers reporting greater than \$91,000 in taxable income. Cut-offs for taxable income deciles are presented in Appendix A.

Figure 1-4

Tax filers in the highest income decile contribute over six times the overall average



Source: Social Policy Simulation Model and Database, Version 22.1.

Note: Deciles are constructed based on tax filers' projected taxable income for 2016.

2. What Bill C-239 Proposes

Bill C-239 proposes to replace the current charitable contributions regime with a new framework for individuals. The new rate structure would be based on the current framework for the federal political tax credit, and would provide that monetary gifts to registered charities made by individuals:

- up to the first \$400 would receive a 75 per cent tax credit;
- for the subsequent \$350 would receive a tax credit of 50 per cent; and,
- all amounts above \$750 would receive a tax credit of 33⅓ per cent.

As well, the amount of the total donations to registered charities eligible for the credit would no longer be capped at 75 per cent of the annual net income of the donor.

As presented in Figure 2-1, the new rate structure would benefit all tax filers, regardless of the amount of tax credit claimed. However, smaller monetary charitable tax credit claims, which are typically made by tax filers with lower taxable income, would receive the most substantial benefit.

Figure 2-1

Current and proposed rate structure for charitable tax credit

<u>Value of claim</u>	<u>Current rate</u>	<u>New rate</u>
<i>Up to \$200</i>	15.0%	75.0%
<i>\$201 to \$400</i>	29.0%	75.0%
<i>\$401 to \$750</i>	29.0%	50.0%
<i>\$751+</i>	29.0%	33.3%

Sources: *Income Tax Act* and Bill C-239.

Note: The current system also provides that tax filers who pay income tax at the highest federal rate (that is, 33 per cent), may claim the same tax credit rate on all donations above \$200, up to the amount of the total federal tax paid at the 33 per cent rate.

2.1. How much will this cost?

What is price elasticity?

This is an economic term that measures the per cent change in the demand for a specific good, in this case donations to charity, in response to the per cent change in the effective price. The effective price in this situation will be the after-tax cost to the tax filer of a \$1 donation to an eligible charity, which will vary depending on the tax credit rate.

There are two aspects to estimating the medium-term fiscal cost of this measure. First is the primary fiscal impact. This is the change in the value of the charitable tax credit that would arise from the existing composition of taxpayer claims (that is, assuming taxpayer behaviour is unchanged).

The second reflects behavioural impacts, which have two components. The first part will reflect that some taxpayers are currently constrained by the existing donation ceiling of 75 per cent of total income and may therefore prefer to increase their monetary charitable tax credit claims above this level once Bill C-239 is promulgated.

The second component will reflect the change in the frequency and amount of taxpayer monetary charitable donations owing to the change in the tax credit rates. Finance Canada has recently presented a literature review and its own independent analysis regarding how charitable donations respond to changes in effective tax rates (also known as price elasticity).

In general, as the after-tax cost of charitable donations decreases (that is, the tax credit rate increases), tax credit claims will rise, all other factors held equal.

The primary fiscal impact is estimated using Statistics Canada's Social Policy Simulation and Database for 2016, and applying the new proposed rates in Bill C-239.⁴ Results are presented in Figure 2-2, and indicate that the initial cost would be about \$1,200 million in 2016, rising to \$1,370 million in forgone federal tax revenues by 2020.

Figure 2-2

Primary impact of new rates proposed in Bill C-239

<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>
<i>Fiscal cost (\$ millions)</i>				
1,200	1,241	1,283	1,326	1,370

Sources: Social Policy Simulation Model and Database, Version 22.1; Bill C-239; and Parliamentary Budget Officer.

Note: The estimated fiscal cost for 2016 is grown at the cumulative average growth rate for Finance Canada's actual and projected cost estimate for the current cost of the federal tax credit for monetary charitable donations between 2010 and 2015.

The Social Policy Simulation Model and Database projects that about 2,000 tax filers made charitable tax credit claims equivalent to 75 per cent of their incomes. The projected total value of these claims was roughly \$10 million. Virtually all affected individuals are in the highest income deciles, with taxable incomes above \$91,000.

Using tax administration data from the Canada Revenue Agency, it is apparent that the last time the Government increased the ceiling on donations from 50 per cent of total income to 75 per cent, charitable tax credit claims by tax filers with incomes over \$100,000 rose more than three times as fast as the overall growth in charitable tax credit claims.

It is assumed that a similar increase would be expected following implementation of Bill C-239 for the roughly 2,000 individuals currently at the ceiling limit. Given that this is a small number of individuals with a commensurately low share of overall donations, it does not have a material fiscal impact on the overall results.

Finance Canada estimates that the price elasticity for charitable giving ranges between -0.7 and -1.5, with a mid-point estimate of -1.1. This means that for a 1 per cent decrease in the after-tax cost of donations, the amount of federal tax credits claimed will increase between 0.7 per cent and 1.5 per cent.

As noted earlier, the after-tax cost of donations will vary inversely with the value of the federal tax credit. As the charitable tax credit increases, the "cost" to the tax filer of their monetary charitable donation will decrease, all other things held equal.

PBO believes that Finance Canada's elasticity estimates are the most credible and comprehensive available. At the same time, they are based on the aggregate average changes in charitable tax credit claims from 1997 to 2012.

As the percentage changes in monetary charitable tax credit rates during this period were notably smaller than the changes contemplated in Bill C-239, it is unclear that a similar linear behavioural relationship will hold. Nevertheless, PBO assumes this to be the case.

The range of potential behavioural impacts arising from the more generous tax credit rate is presented in Figure 2-3. For the mid-point estimate, the cost to the Government due to increased donations is estimated to be \$478 million in 2016, rising to \$546 million in 2020.

Figure 2-3 Behavioural impact of new rates proposed in Bill C-239

	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>
	Fiscal cost (\$ millions)				
<i>Low (-0.7)</i>	304	314	325	336	347
<i>Mid-point (-1.1)</i>	478	494	511	528	546
<i>High (-1.5)</i>	652	674	696	720	744

Sources: Social Policy Simulation Model and Database, Version 22.1; Bill C-239; and Parliamentary Budget Officer.

Note: The estimated fiscal cost for 2016 is grown at the cumulative average growth rate for Finance Canada's actual and projected cost estimate for the current cost of the federal tax credit for monetary charitable donations between 2010 and 2015. The percentage change in the after-tax cost of giving includes existing provincial charitable tax credits.

The overall incremental fiscal cost is presented in Figure 2-4. It incorporates both the primary impact of the new rates for the next five years and the behavioural impact of tax filers, in that they are expected to donate more because of the higher tax credit rates.

Figure 2-4 Overall fiscal cost of Bill C-239

	<u>2016</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>
	Fiscal cost (\$ millions)				
<i>low</i>	1,505	1,555	1,608	1,662	1,718
<i>mid-point</i>	1,678	1,735	1,793	1,854	1,916
<i>high</i>	1,852	1,915	1,979	2,046	2,114

Sources: Social Policy Simulation Model and Database, Version 22.1; Bill C-239; Parliamentary Budget Officer.

Note: The estimated fiscal cost for 2016 is grown at the annual average growth rate for Finance Canada's actual and projected cost estimate for the current cost of the federal tax credit for monetary charitable donations between 2010 and 2015. The percentage change in the after-tax cost of giving includes existing provincial charitable tax credits.

3. Conclusion

If C-239 were implemented, it would increase the cost of the federal charitable tax credit by approximately \$1.7 billion in 2016, rising to \$1.9 billion in 2020. This would bring the total annual cost of the credit to almost \$5 billion each year.

As noted earlier, the existing charitable tax credit regime permits spouses to pool their monetary charitable donations into a single claim to maximize the tax credit. While Bill C-239 would not amend this existing provision, the new tax rate structure would provide a disincentive to do so.

Specifically, as the tax credit rate on smaller donations would now be higher than larger donations, spouses would have an incentive to keep their claims separate, rather than pooling them.

Tax administrative data only report total monetary charitable tax credits claimed by tax filer, rather than by donor. As such, it is impossible to determine which spouse made which donation. However, it is evident that taxpayers would now have an incentive to evenly split their donations between spouses.

This would be expected to change the existing distribution of monetary charitable tax claims by increasing smaller donation amounts, specifically under \$400, for which a 75 per cent credit would be eligible. However, owing to data limitations, this impact is not quantified in the analysis.

Appendix A: Income Deciles

Figure A-1 Taxable income deciles for federal tax filers

	<u>Starts at</u>	<u>Ends at</u>
Decile 1	\$0	\$4,053
Decile 2	\$4,054	\$12,231
Decile 3	\$12,232	\$17,979
Decile 4	\$17,980	\$23,595
Decile 5	\$23,596	\$31,699
Decile 6	\$31,700	\$41,155
Decile 7	\$41,156	\$51,677
Decile 8	\$51,678	\$66,262
Decile 9	\$66,263	\$91,530
Decile 10	\$91,531	NA

Source: Statistics Canada's Social Policy Simulation and Database, Version 22.1.

References

- Income Tax Act (R.S.C., 1985, c. 1 (5th Supp.))*; Section 118. <http://laws-lois.justice.gc.ca/eng/acts/I-3.3/>. Government of Canada. 2016.
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- Social Policy Simulation Model and Database: User Manual Version 22.1. Government of Canada. 2016.

Notes

1. Cultural gifts, Ecological gifts and donations of publicly listed securities are managed under a distinct taxable benefit regime.
2. The *Income Tax Act* permits corporations to deduct charitable contributions from taxable income. Hence the tax value of the charitable contribution will depend on the marginal tax rate of the corporation.
3. The 25% figure is calculated as Finance Canada's total estimated value of the tax expenditure in 2013 (\$2.3 billion), divided by the Canada Revenue Agency's data for the total amount of monetary charitable tax credit claimed by individuals (\$9.3 billion).
4. For the purposes of analysis, the temporary First-time Donors' Credit that is due to expire at the end of 2017 was excluded from the analysis. This credit provides an additional 25% on top of the existing federal rates of 15%, 29% or 33% on up to \$1,000 in donations. To be eligible, tax filers and their spouses must have not claimed the charitable tax credit for the 2008 and later taxation years.