

**TAXES AND CHARITIES:  
AN INTERNATIONAL COMPARISON**

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\* The opinions expressed in this report are those of the author and do not necessarily reflect those of the Department of Canadian Heritage.

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## EXECUTIVE SUMMARY

In the current climate of government cutbacks, many of the services formerly provided by government are being reduced or transferred to the private or so-called “third sector”. This third sector is comprised mainly of voluntary, non-profit organizations, many of which have been granted charitable status. A survey carried out by Statistics Canada in 1986-87 estimated that there were 5.3 million Canadians performing volunteer work. The value of this work, using the average service sector wage as a benchmark, was calculated at approximately \$12 billion (in 1987 dollars). This was equivalent to 53% of the wage bill for the entire retail industry in that year, and 43% of the total wage bill for all of Canada’s public servants, including the armed forces.<sup>1</sup>

In both the 1995 and the 1996 federal Budgets, the Minister of Finance announced changes in the tax system that would encourage higher levels of charitable donations and ensure that the third sector obtains the resources it requires to assume an expanded role. However, these tax measures may represent only a portion of the systemic changes needed to prepare the third sector for the challenges that lie ahead. A number of other related issues, which can be posed as a series of research questions, are also relevant:

- \* What organizations qualify for charitable status under Canadian tax law and regulations?
- \* Is the Canadian definition of charitable status too broad? Too narrow?
- \* Can other countries provide models for Canada with regard to definitions of charitable status?
- \* What kind of tax measures are used by other countries to support charities? Have these measures resulted in demonstrably greater levels of charitable donations or a more robust charitable sector?

To answer these questions, this study therefore had the following objectives:

- \* to determine how other countries have adjusted their definition of charitable status to achieve fairness and accommodate changing public perceptions of the nature of a charity;
- \* to highlight the best mechanisms being used by other countries to ensure that qualified charitable organizations have access to the tax system for fundraising and other purposes;
- \* to evaluate the comparative costs and benefits of alternative approaches to restructuring the tax system.

The countries included in this survey are the **United States, the United Kingdom, France, Australia, New Zealand, Mexico and Japan**. The anglophone and francophone countries were chosen on the assumption that they would have the most direct relevance to the Canadian system, while the other two countries have been included to broaden the scope of the study to reflect an Asian and a Latin American perspective. For comparative purposes, an outline of the current situation in Canada is also included to assist the non-specialized reader.

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<sup>1</sup> Economic Dimensions of Volunteer Work in Canada, pp. 4-5.

Because of the technical and sometimes complex nature of the tax laws governing charitable status, the reader may find it useful to read the country profile for Canada before reading **Chapter 2 - Overview of Findings** and **Chapter 3 - Implications for Canada**. In addition, the reader is encouraged to consult the individual country profiles in **Chapter 4** for details of tax treatment or procedure that are only summarized in the overview in **Chapter 2**.

## CHARITABLE STATUS: APPROACHES AND DEFINITIONS

This international comparison of charitable status in various countries reveals a number of approaches, resulting in a variety of definitions. **Approaches** range from the fairly flexible rules on charitable status in the United States to the very bureaucratic process imposed on organizations seeking charitable status in countries such as France and Japan. Not surprisingly, variations were also found in the **definition of charitable status** in different countries, but overall, the “core” definition of a charity -- one engaged in the relief of poverty, the advancement of religion or education or other activities of public benefit -- was relatively consistent across countries. Wider differences, however, could be found “at the margins”, where some countries had a fairly liberal interpretation of “public benefit”, while others viewed “charity” with a much narrower lens.

The approaches to granting charitable status used by the countries studied can be grouped as follows:

- 1) **The bureaucratic approach** is characterized by a reliance on an official government review (often by more than one department) according to a set of guidelines established either in law or by legal precedence. In some countries this can be a lengthy and convoluted process. Countries adopting this approach include France, Japan and Mexico. Countries that have attempted to streamline their bureaucratic approaches somewhat include Australia, New Zealand and the United States.
- 2) **The “arm’s length” approach** involves review by an agency of the government according to a set of guidelines established by legal precedence or by policy direction. The only country that has adopted this approach is the United Kingdom, which since 1960 has had a Charity Commission, an executive agency staffed by public servants (somewhat like the departmental agencies of the Canadian government). This body considers an organization’s objects and activities to decide whether it is charitable in law.

### **Definition of Charitable Status**

Basic definitions of charitable status were relatively uniform across the countries studied. Almost all countries included organizations promoting religion or education within their definition of a charity. Many, such as the United Kingdom and New Zealand interpreted the word “education” to include the operation of art galleries, museums and libraries and the improvement of sports facilities. Most (except Mexico, France and Australia) include support for religion and religious institutions as charitable endeavours. Japan is unique among the countries surveyed in granting charitable status to political parties and members of the Japanese Diet (parliament).

It is in the area of “purposes beneficial to the community” where the most ambiguity exists and where there is the most variation between countries. Often it is less a matter of **what** is in the official documentation than **how** officials or the courts interpret it that governs whether or not an activity is considered charitable. The definition appears to be continually evolving, particularly in the countries that have based their systems on English Common Law.

Overall, the definition of charitable status outlined in the official government statutes and literature of the countries studied is not always illuminating, since it is open to interpretation either by bureaucrats or by the courts. These interpretations are frequently culturally based (as in the case of political parties in Japan or of religion in France). In the Common Law countries, the definition appears to be heavily dependent upon the liberality of the courts, while in the civil law countries, the definition varies according to the degree to which the government wishes to encourage non-state support for certain sectors of the economy.

In the countries studied, one can also detect **a tendency toward greater definitional flexibility in jurisdictions where the process of granting charitable status is more transparent and less convoluted.** In some countries -- notably the United Kingdom, the United States and New Zealand -- the process of granting charitable status appears to be better organized and certainly better supported by accessible and comprehensive information.

## TAX TREATMENT OF CHARITIES AND DONORS

The findings of this international survey indicate that countries employ a number of tax measures to encourage public support for charities and to provide charities with more privileged treatment within the tax system. Beyond the income tax exemption for recognized charities, which all countries provide, these measures fall roughly into three categories:

- 1) income tax deductions for donors
- 2) capital gains tax exemptions
- 3) other types of tax relief for charities.

### *Income tax deductions for donors*

Canada and New Zealand have switched to tax credits for individual donors, but all other countries studied have remained with direct deductions from income tax for charitable donations.<sup>2</sup> All countries have retained the income tax deduction for corporations as the mechanism for encouraging charitable giving.

Some countries, such as the United Kingdom, provide incentives for higher income taxpayers through a Gift Aid Scheme, which provides extra tax relief for donors with higher tax rates. Others, such as France, permit higher deductions for smaller amounts donated to high-priority charities, such as those providing food and shelter for the homeless. Canada has a two-level tax credit, which gives greater tax relief for larger donations.

Australia is unique in having no ceilings on donations. Other countries tend to have differing ceilings for individuals and corporations, complicated by differing ceilings for different types of donations. The United States has a very generous ceiling of 50% of gross taxable income for individuals donating to most types of charities, with a lower limit of 30% for private non-operating foundations, although differing rules apply for donations of capital property. Corporate deductions are, however, limited to 10% of net income. In Canada, once legislation arising from the 1996 Federal Budget is passed, the annual ceiling on donations by individuals and corporations will rise to 50% of net income -- 100% if the donation is from a deceased taxpayer.

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<sup>2</sup> Income tax deductions permit the full amount of a charitable donation to be deducted from income tax payable. Under a tax credit system, donors receive a credit equal to a specific income tax rate (for example, under current legislation, donors receive a tax credit of 17% if annual charitable donations total under \$200).

The United Kingdom places upper limits on an individual's payroll donations, lower limits on Gift Aid donations and no limits on "deed of covenant" donations.<sup>3</sup> Corporations in the UK have a donations ceiling of 3% of dividends annually and cannot donate gifts of assets or property, but there are no limits on sponsorships. Japan permits individuals to donate up to 25% of gross income annually, and no limits are placed on corporate giving. France places an upper limit of 5% of gross taxable income on individual charitable donations. For corporations, the limit is only .3% of gross taxable income. New Zealand allows individuals only \$500 of donations annually, while corporations are limited to \$4,000 or 1% of income (even less if donations are split among several charities).

### ***Capital gains tax exemptions***

When property that has appreciated in value is donated to a charity, it may be treated in some countries as a capital gain by the donor, requiring the payment of capital gains tax on the "profit" realized.

The United States does not have a capital gains tax on appreciated property donated to charities. This may help to explain why bequests to charity in the years 1984 through 1994 have averaged between 6.5% and 7.5% of all charitable giving. In the United Kingdom, no capital gains tax applies to property gifts made to charity under the deed of covenant scheme. However, both Australia and Canada impose a capital gains tax on appreciated property donated to charities, and representations have been made recently to the governments of both countries recommending that this practice be ended.

### ***Other types of tax relief for charities***

In addition to income tax deductions for charitable donations and capital gains tax exemptions for donors of property, other types of tax measures are utilized by most countries to support the charitable sector. There is no great degree of uniformity of measures across countries, but they fall generally into four categories -- sales tax exemptions, sponsorship incentives, tax treatment of business income and tax treatment of service donations.

Almost all countries exempt charities from sales taxes, either in whole or in part. Those countries with value-added taxes have the most complex arrangements.

A number of the countries studied have incentives that encourage business sponsorships. In the United Kingdom, corporations can claim a 25% deduction from company profits for charitable sponsorships. In France, a corporation can deduct 100% of the cost of sponsoring a cultural event. In both Australia and New Zealand, gifts in support of sports or arts events can be deducted from income tax as business expenses. In Canada, the rules are much less explicit.

Charities often raise revenues through activities that are considered unrelated to their primary charitable purposes (for example, running a cafeteria or operating a parking lot). The income from these unrelated businesses is currently subject to corporate income tax in Canada and does not qualify for the GST exemption. In France, charities are permitted a tax credit equal to 50% of the dividends they earn from French corporations to offset corporate tax owing on unrelated business income. In Japan, charitable income from profit-oriented activities is exempt from income tax if it accounts for less than 30% of a charity's total income. Beyond the 30%

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<sup>3</sup> For a detailed description of how the "deed of covenant" donations system in the United Kingdom works, please see the U.K. country profile in Chapter 4.

limit, profit-oriented income is taxed, but at 27%, rather than the ordinary corporate tax rate of 42%.

The income tax regime in the United States allows a deduction for some out-of-pocket expenses, such as food, lodging and travel expenses, incurred when performing services for a charitable organization. Deduction of out-of-pocket expenses for services rendered to charities is also permitted in Japan. In the United Kingdom, corporations are allowed a business expense deduction for the salaries of employees seconded to charities for extended periods of time.

## IMPLICATIONS FOR CANADA

The results of this survey suggest several questions that should be addressed by federal policy makers:

- 1) Based on the experience of other countries, is it politically and fiscally desirable for the Government of Canada to increase tax incentives for charitable giving?
- 2) Do other countries define “charitable status” more broadly than Canada and should Canada expand its definition of charity to include more types of benevolent organizations?
- 3) Is there a need to adopt a more comprehensive and coordinated policy approach to the issues of charitable giving and to the types of tax benefits available to registered charities?

### ***Enhanced tax incentives***

Raising the ceiling for charitable donations is only one of many suggestions that have recently been made to the federal government to enhance tax incentives and benefits for charities and donors. A summary of the more recent recommendations and some additional suggestions derived from this study are included in Chapter 3 of the report under “Implications for Canada”.

The main questions that need to be answered by policy makers before proposing additional tax incentives for charitable donations are:

- \* **Will they have a positive impact?**
- \* **Will the federal government be willing to increase its tax expenditures for charity?**

This study has found that there is no consensus among economists as to whether tax incentives are efficient means of increasing the level of charitable donations. The inconclusiveness of current research measuring the price elasticity of charitable giving suggests that any arguments favouring enhancements to the tax incentives for charitable giving will have to be built on something other than econometric evidence. One argument that might be used is the relatively small tax expenditures currently made by the federal treasury on behalf of charitable organizations. This would suggest that proposed tax measures that minimize revenues foregone by the treasury (such as the “stretch” target and the heritage building deductions) might have a better chance of acceptance than others where the impact is likely to be higher.

Canada is among the most generous of the countries studied in the level of charitable deductions it permits to both individuals and corporations, suggesting that the federal government believes in the power of tax incentives to provide a positive stimulus to charitable giving. Since many of the current government reductions, both at the federal and provincial levels, are predicated in part on the assumption that the private or charitable sector will assume

the burdens of government in the sectors vacated, the federal government should consider additional tax concessions as one means of increasing propensities to donate. There are certainly other tax incentives -- hitherto largely unexplored -- that would help charities take a more proactive approach to fundraising and revenue generation and to increase the numbers of volunteers willing to donate time and professional services to charity.

### ***Redefining charitable status***

Opening up charitable status to more groups has significant policy and fiscal implications. On the policy side, it would signal the government's intentions with regard to the "third sector" of voluntary, non-profit organizations, indicating the types of activities the government considers important building blocks of Canadian society. On the fiscal side, the granting of charitable status to more groups will result in more tax expenditures by the federal government. This expenditure might be offset by the social utility of higher donations to targeted charities. However, increasing the number of groups pursuing charitable donations could also have a "crowding out" effect, with more competition for dollars from a shrinking pool of donors. Any decision on the question of charitable status must therefore be taken in the context of overall priorities for charitable tax policy.

From the results of this survey, three possible options for definitional clarification emerge:

- 1) introducing clearer guidelines in the *Income Tax Act* or its regulations
- 2) adopting a "two-level" definition of charitable status similar to the New Zealand model, according to which full tax benefits are granted to an *approved charity* and more limited tax benefits to an *approved donee organisation*;
- 3) placing the definitional responsibility at "arm's length" from the government by setting up an "arm's length" agency to determine charitable status, as has been done in the United Kingdom.

### ***A comprehensive and coordinated approach to charitable tax policies***

Given the size of this "third sector" and the expectation that it will take on more of the health, education, social support and community development responsibilities of the public sector, it is somewhat surprising that there is no clear public policy centre for charities and non-profit organizations at the federal level.

The results of this survey suggest that charitable tax policies work best in those countries (e.g. the United Kingdom) with the clearest policy direction and lines of accountability and communications. Canada has been comparatively generous in using the tax system to encourage charitable donations, but is not the most progressive country among those studied in terms of its process for granting charitable status or for monitoring the performance of charities. A clearer policy framework is also needed to guide federal decision makers in designing support measures for charities (including further changes to the tax system) and in determining which types of organizations should qualify for such support.

## **1. SCOPE AND METHODOLOGY OF STUDY**

### ***Scope***

This study was originally undertaken in the spring of 1995 at the request of the Voluntary Action Directorate of the Department of Canadian Heritage to answer the following questions:

- \* How do other countries define “charitable status”?
- \* What is the process for granting such status to organizations?
- \* What are the implications of alternate approaches to defining the charitable status of organizations?
- \* What lessons can this hold for Canada?

Another possible question - what other innovative measures are other countries using to support the charitable sector? -- was also considered for inclusion in this study, but was deferred to a later study which will go beyond the tax system to address a broader field of inquiry.

In the summer of 1995, the principal researcher was re-assigned to other duties until April 1996, and this study was put on hold indefinitely. Following a departmental reorganization in spring 1996, in which the Strategic Research and Analysis Directorate was transferred to the Strategic Management Sector, the study was revived. Part of the mandate of the Strategic Management Sector is to provide leadership on corporate issues. Tax issues are of broad interest to most parts of the Department of Canadian Heritage, whose stakeholders include large numbers of charitable and non-profit organizations. Therefore, the findings of this study are of interest to both clients, only in a broader context.

The countries included in this survey are the **United States, the United Kingdom, France, Australia, New Zealand, Mexico and Japan**. The anglophone and francophone countries were chosen on the assumption that they would have the most direct relevance to the Canadian system, while the other two countries have been included to broaden the scope of the study to include an Asian and a Latin American perspective. For comparative purposes, an outline of the current situation in Canada is also included to assist the non-specialized reader.

### **Key Problems**

In Canada, the *Income Tax Act* does not define what is meant by a “charitable organization”. Therefore, the operative definition of a charity used in this country derives from English common law as interpreted by the courts. In general, the current interpretation used in Canada is based on the categories cited by Lord MacNaughton in the case of The Commissioners for Special Purposes of the Income Tax Act v. Pemsel, (1891) A.C. 531 (H.L.), who held that a charitable organization must perform one or more of the following functions:

- 1) the relief of poverty
- 2) the advancement of education
- 3) the advancement of religion
- 4) some other purpose beneficial to the community.

Many of the activities widely considered charitable today, such as the promotion of harmonious racial relations, amateur sport activities, national unity, patriotism and advocacy, have not been interpreted by Revenue Canada and the Canadian courts as falling within the definition cited above. As a result, many organizations performing functions that are commonly recognized as for the public benefit have not in fact received charitable status from Revenue Canada.

In a climate of prosperity and generous public sector funding, restrictions on the definition of charitable status may have been of minor importance, since charitable organizations falling

outside the Revenue Canada definition could rely upon funding sources other than private donations. In the 1990s, however, when both government and individual support is being cut back, the lack of charitable status, which permits donors to receive tax relief for their donations to eligible charities, has serious financial implications for a large segment of Canada's voluntary sector.

In addition to the question of the types of organizations qualifying for charitable status, alternative methods of supporting charitable organizations through the taxation system may also serve to provide relief for charities facing the harsh fiscal climate of the 1990s. Attention was therefore also paid in the course of this research to tax measures used in other countries to promote more generous giving or to provide charities with tax advantages not available to other organizations.

### ***Research Objectives***

In the light of the problems outlined above, this study has the following objectives:

- \* to determine how other countries have adjusted their definition of charitable status to achieve fairness and accommodate changing public perceptions of the nature of a charity;
- \* to highlight the best mechanisms being used by other countries to ensure that qualified charitable organizations have access to the tax system for fundraising and other purposes;
- \* to evaluate the comparative costs and benefits of alternative approaches to restructuring the tax system.

### ***Research Methodology***

A literature survey was undertaken to obtain information on the tax regimes applicable to charitable organizations in the targeted countries. This information was compiled, and gaps in the database were filled through contacts with embassies of the countries being studied, as well as through consultations with appropriate government officials. A complete bibliography and list of persons consulted is included in Chapter 5 of this report.

Analysis of the documentation focused on the comparative treatment of charities by fiscal authorities in each country. **It should be noted, however, that differing cultural attitudes to charitable giving, particularly in the non-European countries, do have an impact, even on such non-cultural functions as tax law. To the extent that the tax regime has been influenced by differing social assumptions about the nature of philanthropic giving, these will be noted in the analysis. Overall, the reader should be aware that comparability is rendered difficult by differing legal and social contexts and that application of foreign approaches to the Canadian tax regime in support of charities must be done with these differing contexts in mind.**

### ***Structure of the Report***

To maintain a consistent framework for analysis and to organize a great deal of fairly complex information, each of the country profiles has been structured under the same series of headings:

### Country Heading

Provides background information on volume of charitable donations, general attitudes to charitable giving, legal and social climate and contextual factors to help the set the stage for the tax status information.

### Definition of charitable status

Provides the legal definition (if any) used by tax authorities in each country to determine charitable status and outlines any other guidelines used in the process.

### Tax treatment of charities and donors

Provides information on the tax advantages granted to organizations that have charitable status (including both income tax and other taxes). Also provides information on the tax advantages that donors derive from giving to charitable organizations.

### Process for granting charitable status

Outlines the steps that must be followed by an organization to apply for charitable status and the factors taken into account by the tax authorities when considering applications.

## 2. OVERVIEW OF FINDINGS

### CHARITABLE STATUS: APPROACHES AND DEFINITIONS

This international comparison of charitable status in various countries reveals a number of approaches, resulting in a variety of definitions. **Approaches** range from the fairly flexible rules on charitable status in the United States to the very bureaucratic process imposed on organizations seeking charitable status in countries such as France and Japan. Not surprisingly, variations were also found in the **definition of charitable status** in different countries, but overall, the “core” definition of a charity -- one engaged in the relief of poverty, the advancement of religion or education or other activities of public benefit -- was relatively consistent across countries. Wider differences, however, could be found “at the margins”, where some countries had a fairly liberal interpretation of “public benefit”, while others viewed “charity” with a much narrower lens.

#### *Approaches*

The approaches to defining charitable status used by the countries studied can be grouped as follows:

- 1) **The bureaucratic approach** is characterized by a reliance on an official government review (often by more than one department) according to a set of guidelines established either in law or by legal precedence.
- 2) **The arm’s length approach** involves review by an agency of the government according to a set of guidelines established by legal precedence or by policy direction.

Under the **bureaucratic approach**, one or more government departments is typically involved in the review of an organization’s application for charitable status. In some countries this can be a lengthy and convoluted process.

For example, in **France** many non-profit organizations (but not all) are required to obtain “legal personality” -- to be registered with an appropriate government ministry, such as the Ministry of

Higher Education in the case of schools or colleges. Once legal personality is obtained, the organization must then apply to the Ministry of Finance to be recognized for charitable tax purposes. However, tax status may still be denied by the tax authorities at the Ministry of Finance, even if the organization has obtained approval from another ministry. In addition, all charitable organizations in France, whether or not they are a “legal personality” must file their by-laws with the Interior Ministry. Those with legal personalities are also required to file an annual statement with the Interior Ministry.

**Japan and Mexico** have similarly convoluted processes.

In **Japan**, an organization seeking charitable status must first obtain corporate status from the appropriate government ministry and then go to the Ministry of Finance for tax exempt charitable status. According to one source, one-half of all applications are rejected, generally because they do not focus solely on one charitable purpose or have insufficient start-up funding. All charities in Japan are subject to annual review by the ministry that granted them corporate status and, in addition, must file annual corporate tax returns with the Ministry of Finance.

In **Mexico**, private charitable organizations are supervised by the Private Charities Board, a decentralized administrative body falling within the Department of the Federal District. Organizations must apply to this Board for charitable status, a system which involves a two-stage process: application for status, followed by approval of by-laws by the Board, if charitable status is granted. By-laws, once approved by the Private Charities Board, must then be entered in the Public Property Register. Charities are also required to submit annual budgets and work plans for the coming year to the Private Charities Board. In addition, Mexico has a particularly arcane set of rules governing fundraising by charities, which appear to involve a great deal of “policing” by the authorities at the expense of flexibility on the part of the charities. Mexican authorities are said to be studying the need for a less restrictive regulatory environment for charities, mostly at the instigation of the country’s NAFTA partners.

Countries with somewhat more “user friendly” bureaucratic processes include **Australia, New Zealand and the United States**.

In **Australia**, charitable organizations are not compelled by law to seek approval that the donations they receive will be tax deductible. However, if the charity is incorrect in its self-assessment, the onus falls on the taxpayer to demonstrate that his or her donation to the organization is tax-deductible. To avoid putting their donors in such a situation, most charities therefore submit applications to the Australian Taxation Office (ATO), seeking official approval of their charitable status. The Australian Tax Office requires a great deal of documentation in support of an application, but once charitable status is obtained, the ATO’s role appears to be one of benign neglect. Most charities do not have to file income tax returns or any other proof that the tax deductible donations they have received continue to be used for charitable purposes. Australia is also unique in the fact that over 75 organizations are specifically listed in the *Income Tax Assessment Act* as being recognized charities.

In **New Zealand** incorporated charities must first have registered with the Commercial Affairs Division of the Department of Justice before applying to Inland Revenue for charitable status. Inland Revenue makes a number of determinations (such as whether the organization’s purposes are exclusively charitable and whether its constitution or deed of trust is in order) and issues a detailed letter indicating the types of tax exemptions for which the organization qualifies. Organizations have the right to appeal an unfavourable decision. New Zealand is unique among the countries studied in that it has two levels of charitable status -- *approved charities* that qualify for a full range of tax benefits and *approved donee organizations* that

qualify for a more limited range of benefits.

The **United States** is recognized as one of the easier jurisdictions in which to file for charitable status. The Internal Revenue Service makes only two determinations when an organization files for recognition: whether the organization can be recognized as tax-exempt under the *Internal Revenue Code*, subsection 501 (a) and whether it can accept charitable contributions that are deductible by donors for tax purposes. (American tax legislation is fairly explicit about which organizations can qualify.) A new application is required if an organization's legal status changes. However, all tax-exempt organizations, except churches and those with receipts of less than \$25,000 annually, are required to file annual information returns with the IRS, and these reporting requirements are extremely detailed, especially for private foundations. The IRS also maintains Publication 78, a cumulative list of organizations eligible to receive tax deductible contributions, which runs to the size of two big city phone books.

All organizations in **Canada** wishing to register for charitable status under the *Income Tax Act* must apply to the Charities Division of Revenue Canada, submitting an "Application for Income Tax Registration for Canadian Amateur Athletic Associations and Canadian Charities". Official copies of the following documents are also required:

- \* For an incorporated applicant, the certificate of incorporation, letter patent, or memorandum of incorporation.
- \* For an unincorporated applicant, the constitution or trust document bearing the original signatures of at least three of the current directing officers.
- \* For divisions of existing charities, a letter of affiliation signed by an executive officer of the principal charity and a resolution signed by officers of the applicant organization indicating that they will abide by the governing document of the principal charity.
- \* The by-laws of the organization bearing the signatures of at least two of the current directing officers.

This process has recently been criticized by a Canadian Member of Parliament, John Bryden, as being "a situation tailor-made for abuse". Mr. Bryden has stated that "The department (Revenue Canada) issues an advisory giving examples of what it considers to be a charitable activity but applicants are under no obligation to follow them." He maintains that "The net result is that regulations designed by Revenue Canada to govern charities are generally *ad hoc* in nature, inadequate, often ambiguous, and almost always open to a variety of interpretations."<sup>4</sup>

The *arm's length approach* is practised by the **United Kingdom**, which since 1960 had a Charity Commission, an executive agency staffed by public servants (somewhat like the departmental agencies of the Canadian government). This body considers an organization's objects and activities to decide whether it is charitable in law. In doubtful cases, the Commission may consult Inland Revenue (the British equivalent of Revenue Canada) before deciding on charitable status. When it is satisfied that the organization meets charitable criteria, the organization is entered on a central register of charities and becomes eligible for a number of tax benefits. The Charity Commission also provides advice and assistance to charities and serves as a mechanism for dealing with charities that are experiencing legal or financial difficulties. Under statutory powers which came into force in 1995, the Charity Commission has the power to regulate and control certain types of fundraising activity by charities.

<sup>4</sup> John Bryden, M.P. Canada's Charities: A Need for Reform. Ottawa: House of Commons, October 1996, p. 14.

While there does not appear to be a significantly reduced amount of paperwork required to register as a charity in the UK, the existence of the Commission does serve to provide a clear focus for charitable oversight. This visibility, coupled with the Commission's narrowly focused mandate, simplifies communications for the main stakeholders (the charities) and the general public. This is particularly evident in the ease with which "one-stop" information can be obtained via the Charity Commission's Internet Web pages. On the other hand, there is little evidence from the information gathered in the course of this study that the Charity Commission has a great deal of impact on government tax policies with regard to charities.

### **Definition of Charitable Status**

Basic definitions of charitable status were relatively uniform across the countries studied. Almost all countries included organizations promoting religion or education within their definition of a charity. Many, such as the United Kingdom and New Zealand interpreted the word "education" to include the operation of art galleries, museums and libraries and the improvement of sports facilities. Most (except Mexico, France and Australia) include support for religion and religious institutions as charitable endeavours. Japan is unique among the countries surveyed in granting charitable status to political parties and members of the Japanese Diet (parliament).

It is in the area of "purposes beneficial to the community" where the most ambiguity exists and where there is the most variation between countries. Often it is less a matter of **what** is in the official documentation than **how** officials or the courts interpret it that governs whether or not an activity is considered charitable. The definition appears to be continually evolving, particularly in the countries that have based their systems on English Common Law.

In **Australia** a recent study entitled Charitable Organizations in Australia has urged the government to expand the provisions of the *Income Tax Assessment Act* to include small community social welfare organizations, which emphasize self-help and advocacy, among those eligible to receive tax deductible contributions. The Industry Commission, which carried out this study, heard a number of arguments in favour of an expanded definition, including this one from the ANZ Trustees:

It would seem that the current meaning is that a public institution is benevolent only if it provides aid directly and where its dominant objective and activity is the immediate relief of poverty, sickness, distress, misfortune, destitution or helplessness. Thus, institutions whose objectives are designed to prevent the matters for which relief is required and which might involve the provision of timely advice, research into the prevention of the problem rather than its cure, advocacy or the empowering of people to help themselves is not considered benevolent.<sup>5</sup>

In the **United States**, the definitional rules appear to be fairly flexible and have encouraged a wider variety of charitable organizations than in most other countries studied. For example, the fastest-growing type of charity in the U.S. provides services "in kind", making linkages between companies wishing to donate products and non-profit organizations willing to accept them. One of the largest of these charities -- Gifts in Kind International -- is utilized by 25% of Fortune 500 companies to manage product giving programs. The organization claims to have distributed more than \$1 billion in newly manufactured products over the past decade.<sup>6</sup>

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<sup>5</sup> Industry Commission, Charitable Organisations in Australia. Report No. 45. Melbourne: Australian Government Publishing Service, 16 June 1995, p. 283.

<sup>6</sup> Gifts in Kind International Worldwide Web Site: <http://www.giftsinkind.org/Product/Donations/findex.html>.

In **France**, where the non-profit charitable sector has been traditionally weak, tax laws were changed in 1987 to encourage corporate support of cultural and sports events. In addition, tax law recognizes associations that operate for “the advancement of the French language or the creation, promotion or protection of works of art or writers’ works” as charities.

In **Japan**, the desire of large corporations to be seen as “good corporate citizens” has led to the creation of close to 200 grant-making foundations, 20 of which had assets in 1988 of over 3 billion yen (\$22US million). The largest of these private foundations, the Sasakawa Peace Foundation, has assets of about 26 billion yen (\$185A million) and funds charitable activities in support of the environment, security, NGOs in foreign countries and the revitalization of Japanese localities and regions.<sup>7</sup>

In **Mexico**, the *Law on Private Charitable Institutions* includes institutions which “perform works of solidarity aimed at social development”, and the Mexican *Income Tax Act* includes among those organizations eligible to receive tax deductible contributions “societies of authors established in compliance with the *Federal Copyright Law*”.

**New Zealand’s** two-tier system of charitable status, which classifies charitable organizations as either an *approved charity*, with full tax benefits, or an *approved donee organization*, with more limited tax benefits, is unique among the countries studied. Approved charities must carry out charitable activities in one or more of the standard charitable areas -- relief of poverty, advancement of education, advancement of religion or purposes beneficial to the community. Approved donee organizations must use most, but not all, of their funds within New Zealand and have either a cultural purpose (defined as dramatic, theatrical, operatic, ballet, choral or musical activities) or a benevolent or philanthropic purpose not falling under one of the “charitable heads”, as outlined above.

In addition, New Zealand’s tax authorities have included such activities as acquiring and passing on knowledge (for example, the publishing and selling of law reports) within the definition of “advancement of education” and the afforestation or creation of national parks within the definition of charities having purposes “beneficial to the community”.

This international survey has shown that Canada is about the middle of the pack in terms of the complexity of its process for determining charitable status and its liberality in interpreting the Common Law definition. Whatever the policy decision on opening up or restricting the definition, there is certainly room for clearer public guidelines on what constitutes a “purpose beneficial to the community”. From the results of this survey, three possible options for definitional clarification emerge:

- 1) **introducing clearer guidelines in the *Income Tax Act* or its regulations**
- 2) **adopting a “two-level” definition of charitable status similar to the New Zealand model**
- 3) **placing the definitional responsibility at “arm’s length” from the government by setting up an “arm’s length” agency to determine charitable status.**

### ***Definitional evolution***

Overall, the definition of charitable status outlined in the official government statutes and literature of the countries studied is not always illuminating, since it is open to interpretation either by bureaucrats or by the courts. These interpretations are frequently culturally based (as

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<sup>7</sup> Roger M. Williams, *Foundation News*. November-December (Year unknown), p. 27.

in the case of political parties in Japan or of religion in France). In the Common Law countries, the definition appears to be heavily dependent upon the liberality of the courts, while in the civil law countries, the definition varies according to the degree to which the government wishes to encourage non-state support for certain sectors of the economy.

**In the countries studied, one can also detect a tendency toward greater definitional flexibility in jurisdictions where the process of granting charitable status is more transparent and less convoluted.** Since access to tax benefits is the direct result of charitable status for an organization, it is unrealistic to assume that this process will ever be entirely free from the constraints of government bureaucracy. However, in some countries -- notably the United Kingdom, the United States and New Zealand -- the process of granting charitable status appears to be better organized and certainly better supported by accessible and comprehensive information. For example, the Charity Commission in the United Kingdom, perhaps because it has a clear responsibility to set the ground rules for charities in that country, has issued clear guidelines on the extent and nature of political activity in which a charity is permitted to engage without jeopardizing its charitable status.

## TAX TREATMENT OF CHARITIES AND DONORS

Appendix 1, *Tax Treatment of Charities and Donors - International Comparison*, summarizes the tax treatment of charities and donors in the countries studied. Canada is included for comparison purposes. In most cases, this summary does not include the numerous qualifications and conditions attached to various benefits by tax authorities nor does it take into account the differing legal and social contexts in which charitable donations are made in each country. The reader is therefore encouraged to consult the country profiles in Chapter 4 for detailed explanations of the information summarized below.

The findings of this international survey indicate that countries employ a number of tax measures to encourage public support for charities and to provide charities with more privileged treatment within the tax system. Beyond the **income tax exemption** for recognized charities, which all countries provide, these measures fall roughly into three categories:

- 1) income tax deductions for donors
- 2) capital gains tax exemptions
- 3) other types of tax relief for charities.

### 1) Income tax deductions for donors

Tax expenditures are expensive items for governments, and it is always a balancing act for public policy to provide sufficient incentive for donors to donate while minimizing the revenues foregone by the treasury. The findings indicate that there are no standard “formulas” for this charitable equation, although it is possible to gain some idea from the tax incentives provided of the relative priority given to charitable giving in a country.

The first issue that arises is whether to give donors a **tax deduction or a tax credit** for charitable giving. Under a system of tax deductions, taxpayers can deduct the full amount of any donation from income tax owing. Under a tax credit system, taxpayers receive a credit equal to a certain percentage of taxes owing. There is an ongoing debate among economists as to which constitutes a more efficient incentive to give. The question was considered recently in Australia, which looked at the feasibility of replacing the current charitable deduction in that country with a “tax rebate” (tax credit), which it was argued would be “the same for all taxpayers across all tax brackets” and would ensure that “the taxpayer’s marginal rate of tax would not

longer dictate the size of the benefit the donor receives”.<sup>8</sup> However, the Commission studying the question recommended against the changeover, concluding that:

The effect of a move to a tax rebate on overall giving and on the allocation of funds among organisations is unclear. Further the studies undertaken on the efficiency of tax deductibility indicate that the current provisions may well be treasury efficient.<sup>9</sup>

**Canada and New Zealand** have switched to tax credits for individual donors, but **all other countries** studied have remained with direct deductions from income tax for charitable donations. **All countries** have retained the income tax deduction for corporations as the mechanism for encouraging charitable giving.

The second issue is **how large a deduction or tax credit** should be allowed. Some countries, such as the **United Kingdom**, provide incentives for higher income taxpayers through a Gift Aid Scheme (described in UK country profile below), which provides extra tax relief for donors with higher tax rates. Others, such as **France**, permit higher deductions for smaller amounts donated to high-priority charities, such as those providing food and shelter for the homeless. **Canada** has a two-level tax credit, which gives greater tax relief for larger donations.

A third and related issue is **how much** can be donated -- or more precisely, whether limits should be placed on donor generosity (and treasury liability). **Australia** is unique in having no ceilings on donations. Other countries tend to have differing ceilings for individuals and corporations, complicated by differing ceilings for different types of donations.

The **United States** has a very generous ceiling of 50% of gross taxable income for individuals donating to most types of charities, with a lower limit of 30% for private non-operating foundations, although differing rules apply for donations of capital property. Corporate deductions are, however, limited to 10% of net income.

**Canada** will soon join the ranks of the more generous, once legislation arising from the 1996 Federal Budget is passed, permitting donations by individuals and corporations of up to 50% of net income -- 100% if the donation is from a deceased taxpayer. Canada's system, however, is among the most complex when setting ceilings on donations of property, with different rules applying, depending on whether the taxpayer is giving cultural property, capital property or ecologically-sensitive land.

The **United Kingdom** places upper limits on an individual's payroll donations, lower limits on Gift Aid donations and no limits on "deed of covenant" donations.<sup>10</sup> Corporations have a ceiling of 3% of dividends annually and cannot donate gifts of assets or property, but there are no limits on sponsorships.

**Japan** permits individuals to donate up to 25% of gross income annually, and no limits are placed on corporate giving. However, **France and New Zealand** are much more restrictive.

<sup>8</sup> Industry Commission, Charitable Organisations in Australia. Report No. 45. Melbourne: Australian Government Publishing Service, 16 June 1995, p. 281.

<sup>9</sup> Charitable Organisations in Australia, p. 282.

<sup>10</sup> For a detailed description of the "deed of covenant" system of donations, see U.K. country profile below.

**France** places an upper limit of 5% of gross taxable income on individual charitable donations. For corporations, the limit is only .3% of gross taxable income. **New Zealand** allows individuals only \$500 of donations annually, while corporations are limited to \$4,000 or 1% of income (even less if donations are split among several charities).

## 2) Capital gains tax exemptions

When property that has appreciated in value is donated to a charity, it may be treated in some countries as a capital gain by the donor, requiring the payment of capital gains tax on the “profit” realized. This unrealized income may provide a disincentive for giving, particularly when the taxpayer’s donations are near the permitted annual ceiling, and there are no provisions in the tax system for carrying over excess deductions or credits to the next tax year.

The **United States** does not have a capital gains tax on appreciated property donated to charities. This may help to explain why bequests to charity in the years 1984 through 1994 have averaged between 6.5% and 7.5% of all charitable giving.<sup>11</sup> In the **United Kingdom**, no capital gains tax applies to property gifts made to charity under the deed of covenant scheme. However, both **Australia and Canada** impose a capital gains tax on appreciated property donated to charities, and representations have been made recently to the governments of both countries recommending that this practice be ended.

The Australian Industry Commission that examined charitable giving in 1994 expressed concern about the dampening effect of capital gains tax on bequests of assets:

... when an asset passes, by virtue of death, to a tax-exempt body, the deceased is deemed to have disposed of the asset to that beneficiary immediately prior to death for a consideration equal to the market value of the asset at the date of death. The estate is, therefore, immediately liable for any capital gains tax.

In addition, it noted that “the burden of the capital gains tax may fall on the tax exempt organisation if there are no other beneficiaries” and recommended that “... assets bequeathed to charitable organisations that enjoy tax deductibility status should be free from any capital gains tax liability”.<sup>12</sup>

Similar concerns have been expressed by the Canada Council, which in February 1996 observed that:

In Canada, while a donor receives a tax receipt for the market value of a gift of capital property, he or she must pay full capital gains tax on the difference between the adjusted cost base and the market value at the time of the gift. This tax provides a disincentive to donate gifts of appreciated property. Gifts of appreciated property to registered charities should be exempted from capital gains tax. Because of our aging population, potential increases in charitable giving might be expected as a result.<sup>13</sup>

<sup>11</sup> Nina Kressner Cobb, Looking Ahead: Private Sector Giving to the Arts and Humanities. Washington: President’s Committee on the Arts and Humanities, no date, p. 9. No comparable figures are available for Canada.

<sup>12</sup> Charitable Organisations in Australia, pp. 316-317.

<sup>13</sup> “Canada Council Task Force calls for ‘Fairer treatment’ for the arts in tax system”, Canada Council Press Release, (February 16, 1996), p. 2.

Neither the Australian nor the Canadian government has responded to these recommendations to date.

### 3) Other types of tax relief for charities

In addition to income tax deductions for charitable donations and capital gains tax exemptions for donors of property, other types of tax measures are utilized by most countries to support the charitable sector. There is no great degree of uniformity of measures across countries, but they fall generally into four categories -- **sales tax exemptions, sponsorship incentives, tax treatment of business income and tax treatment of service donations.**

#### *Sales tax exemptions*

Almost all countries exempt charities from sales taxes, either in whole or in part. Those countries with value-added taxes have the most complex arrangements.

In the **United Kingdom**, charities are exempt from paying the Value-Added Tax on most voluntary transfers of assets, including donations, rent, memberships, sponsorships and “one-off” fundraising events. In addition, a number of charity purchases, such as media advertising and construction supplies for charity buildings are zero-rated (meaning they are taxable, but at 0%).

In **New Zealand**, charitable income from many sources is exempt from the Goods and Service Tax. While the exemption system does not appear to be as broad as in the United Kingdom or Canada, it is clearly explained in Inland Revenue literature, along with the many other tax benefits that are available to charities.

**Canada’s Goods and Services Tax (GST)** does not apply to most charitable activities, and charities that are considered “small suppliers” are not required to register for the GST. Under the current system, **all** charities, whether registered or not, qualify for a 50% rebate of the GST paid on such items as office supplies, which have to be purchased by the charity to carry on its primary activities. However, to obtain the 100% rebate of GST that a charity pays to conduct its related non-exempt businesses (such as running a cafeteria or offering adult fitness classes), a charity **must** register, no matter what its size. This complicated scheme of exemptions, zero-ratings and rebates is administered separately from the income tax-related elements of the charity tax system by the Custom and Excise arm of Revenue Canada.

Changes to the charity provisions of the Canadian GST regime are also being introduced as a result of announcements in the 1996 Federal Budget. However, it is not apparent that the total package of changes, including those affecting the charitable giving ceilings discussed in subsection 1) above, has been developed with any overall charitable sector strategy in mind.

#### *Sponsorship incentives*

Business sponsorships of charitable activities are a growing and somewhat controversial aspect of charitable giving. Arguments are often made that this type of support skews charitable activities toward the priorities of business, rather than the needs of charities and their clientele. However, for certain types of charities, particularly those concerned with the arts and sports, it is likely that this form of corporate giving will only increase in importance. For example, a recent study done for the President’s Committee on the Arts and Humanities in the United States observed that:

In the late eighties, responsibility for setting policy for giving to the arts began to move from corporate-giving departments to marketing, advertising, public relations, and human resources departments and became much more market-driven.<sup>14</sup>

In Canada, research by the Canadian Centre for Business in the Community (a division of the Conference Board of Canada) has indicated that corporate funding for arts, culture, sports and recreation is moving from donations to sponsorships.<sup>15</sup>

A number of the countries studied have incentives that encourage business sponsorships. In the **United Kingdom**, corporations can claim a 25% deduction from company profits for charitable sponsorships. In **France**, a corporation can deduct 100% of the cost of sponsoring a cultural event. In both **Australia and New Zealand**, gifts in support of sports or arts events can be deducted from income tax as business expenses. In **Canada**, the rules are much less explicit. While business sponsorships of charitable activities are a fact of life, Revenue Canada provides no specific guidelines on this practice, other than the following paragraph in Interpretation Bulletin 297R2:

Section 118.1 and subsection 110.1(1) are not applicable to donations of property where its cost has been or should be charged as a business expense. For example, if a taxpayer transfers merchandise or supplies to a charity in consideration of a right, privilege, material benefit or advantage, such as promotion or advertising for the taxpayer's business, then the transfer would not be a gift.<sup>16</sup>

According to an official of the Charities Division of Revenue Canada, this relative silence on the subject is not a problem for businesses, which prefer to make individual sponsorship arrangements tailored to their specific needs, usually deducting any expenses incurred as business or advertising costs.<sup>17</sup>

### *Tax treatment of business income*

Charities often raise revenues through activities that are considered unrelated to their primary charitable purposes (for example, running a cafeteria or operating a parking lot). While the income from these unrelated businesses is usually directed back to finance charitable activities, it is often viewed as unfair competition to private sector firms. Therefore, the income from these unrelated business is currently subject to corporate income tax in **Canada** and does not qualify for the GST exemption.

In **France**, charities are permitted a tax credit equal to 50% of the dividends they earn from investments made in French corporations to offset corporate tax owing on unrelated business income.

In **Japan**, charitable income from profit-oriented activities is exempt from income tax if it accounts for less than 30% of a charity's total income. Beyond the 30% limit, profit-oriented income is taxed, but at 27%, rather than the ordinary corporate tax rate of 42%. Certain charities in Japan, such as social welfare organizations and private educational institutions, are

<sup>14</sup> Looking Ahead: Private Sector Giving to the Arts and Humanities, p. 14.

<sup>15</sup> Presentation to Department of Canadian Heritage by George M. Khoury and Peri Lynn Turnbull, Canadian Centre for Business in the Community, June 26, 1996.

<sup>16</sup> Revenue Canada Taxation, Interpretation Bulletin No. IT-297R2, "Gifts in Kind to Charity and Others", March 21, 1990, paragraph 8, p. 3.

<sup>17</sup> Conversation with Carl Juneau, Charities Division, Revenue Canada, July 1996.

permitted a 50% deduction or 2 million yen (whichever is greater) against income tax owing on profit-oriented activities, as long as this income is used for charitable purposes.

#### *Tax treatment of service donations*

While donation of cash or property is permitted in one form or another in most of the countries studied, only a few permit the deduction of expenses incurred when an individual or corporate taxpayer donates services or professional expertise to a charity.

The income tax regime in the **United States** allows individuals a deduction for some out-of-pocket expenses, such as food, lodging and travel expenses, incurred when performing services for a charitable organization. Deduction of out-of-pocket expenses for services rendered to charities is also permitted in **Japan**. In the **United Kingdom**, corporations are allowed a business expense deduction for the salaries of employees seconded to charities for extended periods of time. None of the other countries studied, including Canada, permit this type of deduction.

A study done by the Department of the Secretary of State in 1990 calculated that out-of-pocket expenses of Canadian volunteers in 1986-87 were \$841 million or an average of \$158 per volunteer or about 83 cents per hour per volunteer. It also concluded that:

... for every hour of volunteer work contributed, volunteers made another contribution of 83 cents in the course of performing their work. Judged from another perspective, individual donations to registered charities totalled \$2.2 billion in 1986, consequently out-of-pocket expenses were equivalent to 38 per cent of donations. That is, for every dollar donated to charities, volunteer workers contributed another 38 cents through expenses.<sup>18</sup>

These are individual costs only and do not take into account the expenses that might be incurred by corporations in rendering services, such as professional accounting expertise, to registered charities.

### **3. IMPLICATIONS FOR CANADA**

The results of this survey suggest several questions that should be addressed by federal policy makers:

- 1) Based on the experience of other countries, is it politically and fiscally desirable for the Government of Canada to increase tax incentives for charitable giving?
- 2) Do other countries define "charitable status" more broadly than Canada and should Canada expand its definition of charity to include more types of benevolent organizations?
- 3) Is there a need to adopt a more comprehensive and coordinated policy approach to the issues of charitable giving and to the types of tax benefits available to registered charities?

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<sup>18</sup> David P. Ross, Economic Dimensions of Volunteer Work in Canada. Ottawa: Supply and Services Canada, January 1990, p. 4.

None of these are simple questions, and none of them can be answered categorically by borrowing from the experiences of other countries. Nevertheless, it is possible to examine the incentives and administrative practices used by other countries to determine if they are applicable within Canada's current political and fiscal climate.

### **1) Enhanced tax incentives**

Most governments in Canada are undertaking severe belt-tightening to reduce deficits and debt levels. As a result, most charitable organizations are experiencing reductions in government funding and are being forced to turn to individual and corporate donors to replace lost revenues. Charities are exerting pressure on governments to alter the tax system to make private donations to charity more attractive -- with some success. For example, in February 1996, the Canada Council recommended that the annual limit for charitable donations be raised from 20% of taxable income to 50% of taxable income, and this suggestion was incorporated into the 1996 Federal Budget.

Raising the ceiling for charitable donations is, however, only one of many suggestions that have recently been made to the federal government to enhance tax incentives and benefits for charities and donors. Recently, the Standing Committee on Finance has recommended:

- \* exempting donations of appreciated property from capital gains tax;
- \* permitting a tax claim equal to 100% of the donor's income for permanent endowments;
- \* permitting claims for bequests to be carried back for two years up to a limit of 100% of the benefactor's income;
- \* introducing a tax credit for charitable donations by corporations that, for large corporations, would be of equal value to the current deduction;
- \* introducing a "stretch target" for donations other than appreciated capital property that would permit a higher rate of tax credit for donations that exceed those made by a taxpayer in any prior year;
- \* exempting from withholding tax any gifts to charity made from a Registered Retirement Savings Plan;
- \* extending charitable status to community economic development organizations;
- \* allowing Canadian foundations to make program-related investments (e.g. low-interest loans for community economic development);
- \* ensuring that the tax guide provides information on the real value of charitable tax credits.<sup>19</sup>

The Canada Council has also recently recommended that:

- \* gifts in which capital is held for at least 10 years be eligible for deduction against 1000% of the donor's income and be excluded from the donee's disbursement quota;

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<sup>19</sup> Fifth Report of the Standing Committee on Finance December 1996. (Worldwide Web site: [http://www.parl.gc.ca/committees342/fine/reports/05\\_96-12/09.html](http://www.parl.gc.ca/committees342/fine/reports/05_96-12/09.html).)

- \* the “stretch target” be available to both small donors and corporations, with a different rate structure for small and large corporations;
- \* charities be permitted to establish pooled income funds;
- \* recaptured depreciation be included in the annual giving limit.<sup>20</sup>

In addition, the research done for this study indicates that other possible tax measures might include:

- \* expanding GST exemptions to include a broader range of charity inputs or outputs (for example, the revenue from unrelated businesses or the cost of building materials for charity construction);
- \* exempting charity’s unrelated business income from income tax or taxing it at a lower rate or, alternatively, permitting offsetting tax credits for other fiscally desirable behaviour, such as holding securities from Canadian companies;
- \* encouraging more business sponsorships, particularly in arts and sports, by offering enhanced deductions from corporate income tax;
- \* introducing a tax incentive to permit donation of services or the deduction of out-of-pocket expenses for volunteers.

The federal government is not lacking for suggestions in this area. Whether any of these measures are feasible is the issue to be resolved.

On the “**pro**” side of the argument, Canadians appear to be reasonably receptive to the idea of the general public and the corporate sector providing a larger share of the support for charities than government.

A 1995 poll by Goldfarb indicated that 24% of adult Canadians believe that the general public should be **most** responsible for providing funds for charitable and non-profit organizations. This compares to 21% who thought government should be most responsible and 20% who thought business should be most responsible.<sup>21</sup> Canadians have also indicated that they would like to see greater corporate support for charities, with 57% stating that cash donations would be the most effective way for corporations to support charities (as compared to 23% who felt corporations could provide community access to resources such as computers and 16% who thought corporations should free up employee time to allow them to volunteer).<sup>22</sup>

These attitudes are accompanied by a growing public realization that government support for many charitable activities may no longer be adequate. For example, an Angus Reid poll conducted in February 1996 found that 88% of those surveyed agreed with the statement that “because of government cutbacks, I feel there is a growing need for charities and other groups to help the poor and needy in our society”.<sup>23</sup>

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<sup>20</sup> Canada Council Task Force on Tax Incentives for the Arts - Recommendations, November 1996.

<sup>21</sup> The Goldfarb Report, Overview, Sector Book 1. 1995, p. 165.

<sup>22</sup> The Goldfarb Report, Overview, Sector Book 1, p. 166.

<sup>23</sup> Quoted in Bob Harvey, “Canadians’ attitudes hardening - Fewer are willing or able to help”, The Ottawa Citizen, July 20, 1996, p. C7.

On the “con” side, it is by no means certain that Canadians are willing or able to increase their current level of support for charities. In December 1995, Statistics Canada reported that 3% fewer Canadians donated to charity in 1994 than in 1993. Donations to registered charities increased by only 1% in 1994, leading Statistics Canada to conclude that the lowered ceiling for the 29% tax credit that was introduced in 1994 had “minimal impact”.<sup>24</sup>

According to the Angus Reid polling firm, between August 1994 and February 1996, the number of Canadians who said they felt a personal responsibility to help people in poorer countries fell from 64% to 55%. While 51% of these respondents felt that government should maintain levels of aid to third world countries, only 25% said that they would be willing to pay higher taxes to ensure that this happened.<sup>25</sup>

The main questions that need to be answered by policy makers before proposing additional tax incentives for charitable donations are:

- \* **Will they have a positive impact?**
- \* **Will the federal government be willing to increase its tax expenditures for charity?**

Again, there are no definitive answers. **With regard to the impact of increased tax incentives on levels of charitable giving, evidence is contradictory.** When respondents to the February 1996 Angus Reid poll were asked why they gave to charity, they responded as follows:

- 82% - I think people who have more have an obligation to share with people who have less.
- 78% - I feel very uneasy when I see poor children and adults suffering on television.
- 72% - My religious faith teaches me to share with the less fortunate.
- 63% - I give donations because it makes me feel good.
- 20% - Mainly because it reduces the amount of tax I pay.<sup>26</sup>

A recent survey by the Canadian Centre for Business in the Community asked corporations if tax incentives would likely increase allocation of funds to arts and culture. All respondents replied that “while tax incentives are ‘nice’ they are not an incentive for the allocation of funds to specific sectors.”<sup>27</sup>

On the other hand, studies in the United States suggest that the tax treatment of charitable giving has a substantial effect on donations. Charles Clotfelter, author of a 1985 study entitled Federal Tax Policy and Charitable Giving, concluded that:

Federal tax policy has a substantial impact on the level and distribution of charitable giving in the United States. ... empirical analysis suggests that support for charitable organizations responds both to explicit tax incentives for charitable contributions and to

<sup>24</sup> Statistics Canada, “Charitable donations”, The Daily, December 13, 1995, p. 1.

<sup>25</sup> Canadians’ attitudes hardening - Fewer are willing or able to help”, p. C7.

<sup>26</sup> “Canadians’ attitudes hardening - Fewer are willing or able to help”, p. C7.

<sup>27</sup> Presentation to Department of Canadian Heritage by George M. Khoury and Peri Lynn Turnbull, Canadian Centre for Business in the Community, June 26, 1996.

general changes in effective tax schedules.<sup>28</sup>

Unfortunately, there is no consensus among economists as to whether these incentives are efficient means of increasing the level of charitable donations. A study done in 1995 by Ian Pomroy of the Strategic Research and Analysis Directorate of the Department of Canadian Heritage reviewed some of the literature on the subject and reported contradictory results. Some researchers found a price elasticity greater than one for charitable giving (meaning that for every 1% reduction in the price of giving, charitable donations will increase by more than 1%). Others found no evidence to support this contention, leading to the conclusion that shortcomings in the data sets would have to be overcome before definitive results can be obtained.<sup>29</sup> The Industry Commission in Australia studying charitable organizations did a similar survey in 1994 of 16 econometric studies on the price and income elasticities of giving. It found a mean price elasticity of -1.24, suggesting that “tax deductibility of donations is an efficient and desirable way for governments to finance the output of [community social welfare organisations].<sup>30</sup> However, like the Strategic Research and Analysis Directorate, it also found contradictory evidence, leading it to conclude that “the evidence on the treasury efficiency of tax deductibility of donations is ambiguous”.<sup>31</sup>

**Current concern about the size of the federal deficit suggests that any enhancements to the tax incentives for charitable giving will have to be designed to have a relatively small impact on tax expenditures currently made by the federal treasury on behalf of charitable organizations, while at the same time increasing the propensity to donate.** The partial profile of tax expenditures for charitable purposes contained in the country profile for Canada in Chapter 4 indicates that, in 1992, revenues foregone by the federal treasury for the charitable donations credit and rebates of the GST for charities and non-profit organizations amounted to about \$1.5 billion or just over 1% of the federal expenditures in that year. This does not include the corporate income tax foregone, nor the cost of exempting charitable and non-profit organizations from income tax, which the Department of Finance was unable to estimate. However, since individuals are the largest donors to charity and the size of most charities is relatively small, it can be assumed that total tax expenditures by the federal government for charities is likely a fairly low percentage of total spending, even if foregone corporate and charitable organization tax revenues are factored in. The raising of the annual ceiling on charitable donations by the Minister of Finance was likely accepted because it simply accelerated tax credits that would otherwise have been claimed over up to five years under existing income tax provisions. **This would suggest that proposed tax measures that minimize revenues foregone by the treasury (such as the “stretch” target and the heritage building deductions) might have a better chance of acceptance than others where the impact is likely to be higher.**

Charitable organizations feel the impact of reduced federal expenditures much more than most other sectors of the economy. A study done by the Canadian Centre for Philanthropy in 1994 indicated that for charities:

<sup>28</sup> Quoted in Looking Ahead: Private Sector Giving to the Arts and Humanities, p. 31. This report also notes that elsewhere in the Clotfelter study he concludes that the repeal of the charitable deduction in the U.S. would cause total charitable giving to fall by one-quarter.

<sup>29</sup> Ian Pomroy, An Analysis of a Number of Tax and Economic Issues Related to Charitable Giving and Volunteering. (Draft 1) Ottawa: Strategic Research and Analysis Directorate, Department of Canadian Heritage, May 1995, pp. 5-6.

<sup>30</sup> Charitable Organisations in Australia, p. J10.

<sup>31</sup> Charitable Organisations in Australia, p. J.11.

The ratio of government funding to individual funding is approximately 5.8 to 1 (for every \$1 contributed by individuals as donations, government provides \$5.80). Therefore, a 1% cut in government grants and transfers to charities would need to be met by a 5.8% increase in individual donations in order for overall funding to remain constant. To recover a 1% reduction in government funding, corporate donations would have to increase 49%.<sup>32</sup>

The bulk of federal government Program Review cuts are only now taking effect and are slated to continue until 1998-99 and, given their heavy reliance on shrinking government grants, charities will urgently require alternative revenue sources.

**Since many of the current government reductions, both at the federal and provincial levels, are predicated on the assumption that the private or charitable sector will assume the burdens of government in the sectors vacated, there are undoubtedly sound strategic reasons for the federal government to explore tax concessions as one means of increasing propensities to donate. There are certainly other tax incentives -- utilized to varying degrees by other countries and hitherto largely unexplored -- that would help charities take a more proactive approach to fundraising and revenue generation and to increase the numbers of volunteers willing to donate time and professional services to charity.**

## **2) Redefining charitable status**

The original impetus for this international survey was the need to develop better mechanisms for granting "charitable status" to organizations -- mechanisms which recognized the changing nature of activities undertaken for public benefit. This has been a long-standing area of dispute between the Department of Canadian Heritage and Revenue Canada Taxation. A study done for the Secretary of State in 1987 showed that of the 453 groups funded by that department at that time, two-thirds could not obtain charitable status from Revenue Canada. Aboriginal representative groups, women's groups and official language groups appeared to have the most problems. Another unpublished study done for the Voluntary Action Directorate in the early 1990s pointed out the following:

1. The promotion of race relations is not charitable.
2. The promotion of better international understanding is not charitable ... though the promotion of international trade is.
3. The promotion of multiculturalism is not charitable.
4. The promotion of a specific ethnic culture is not charitable.
5. The promotion of patriotism is not charitable.
6. Running child care centres is not charitable unless the care is linked to the "poverty" of the parent.
7. Most sports organizations are not charitable ... including those for disabled athletes.

(This is a controversial area where there has been considerable debate at both federal and provincial levels and at least one court decision ... which Revenue says it will not follow!)<sup>33</sup>

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<sup>32</sup> David Sharpe, *A Portrait of Canada's Charities: The Size, Scope and Financing of Registered Charities*. Toronto: Canadian Centre for Philanthropy, 1994, p. 31.

<sup>33</sup> Arthur B.C. Drache, Q.C., *The Voluntary Action Directorate: Rethinking the Mandate*. Ottawa: no date, pp. 10-11. (The reference to the 1987 study was made by Drache.)

**Opening up charitable status to more groups has significant policy and fiscal implications.** On the policy side, it would signal the government's intentions with regard to the "third sector" of voluntary, non-profit organizations, indicating the types of activities the government considers important building blocks of Canadian society. If these building blocks do indeed include groups that care for children, promote racial harmony and encourage amateur athletes at the community level, then improving their access to charitable dollars may make sense. On the fiscal side, the granting of charitable status to more groups will result in more tax expenditures by the federal government. This expenditure might be offset by the social utility of higher donations to targeted charities. However, increasing the number of groups pursuing charitable donations could also have a "crowding out" effect, with more competition for dollars from a shrinking pool of donors.<sup>34</sup> Any decision on the question of charitable status must therefore be taken in the context of overall priorities for charitable tax policy.

This international survey has shown that Canada is about the middle of the pack in terms of the complexity of its process for determining charitable status and its liberality in interpreting the Common Law definition. Whatever the policy decision on opening up or restricting the definition, there is certainly room for clearer public guidelines on what constitutes a "purpose beneficial to the community". From the results of this survey, three possible options for definitional clarification emerge:

- 1) **introducing clearer guidelines in the *Income Tax Act* or its regulations**
- 2) **adopting a "two-level" definition of charitable status similar to the New Zealand model**
- 3) **placing the definitional responsibility at "arm's length" from the government by setting up an "arm's length" agency to determine charitable status.**

#### *Clearer guidelines in the Income Tax Act*

In July 1996, the Federal Court of Appeal issued a ruling that awarded charitable status to the Vancouver organization providing free access to the information highway -- one of a number of so-called "Freenets" established in major cities throughout Canada -- on the basis of the fact that it provided a public benefit similar to that of a highway or a bridge. After having been denied charitable status by Revenue Canada in 1994, the Vancouver Freenet had utilized its option to appeal and, as the press reported on the item, had "opened the door for the National Capital Freenet to qualify for charitable status and raise more money".<sup>35</sup>

In his ruling on this matter, Mr. Justice James Hugessen noted that "some creative legislative intervention would not be out of order". Commenting on Justice Hugessen's remark, Peter Calmai, editor of The Ottawa Citizen, observed that "MPs may complain about judges usurping the duties of Parliament but, when it comes to deciding what's a charity, the politicians would rather the courts take the heat".<sup>36</sup>

In fact, the politicians (and the bureaucrats working for them) currently **do** "take the heat" and would continue to do so under any revised statutory regime. Arthur Drache pointed out in his unpublished report for the Voluntary Action Directorate:

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<sup>34</sup> This concern has been expressed by arts and humanities groups in the United States, leading the President's Committee on the Arts and Humanities to conclude that that loss of federal funding would be unlikely to increase support from other sources. (Looking Ahead: Private Sector Giving to the Arts and Humanities, p. 33).

<sup>35</sup> Stephen Bindman and Ian MacLeod, "Freenet gets boost in first major ruling on cyberspace", The Ottawa Citizen, July 10, 1996, p. A1.

<sup>36</sup> Peter Calamai, "Freenet's ancestor from 1601", The Ottawa Citizen, July 13, 1996, p. B6.

The problems with using the statutory route lie in the fact that very precise legislation must be drafted and that, in the end, the decision making power remains with Revenue Canada. Thus, given new statutory criteria for “deemed charities”, Revenue will still have to examine each one on a case by case basis. The bottom line is that the Charities Division will still be overwhelmed with work and the bureaucrats will still have to make hard decisions.<sup>37</sup>

**However, somewhere between total reliance on the courts for definitional clarification and extreme legislative precision, there is definitely room for greater policy guidance for the Revenue Canada Taxation officials.** Underlying the controversy about charitable definitions is the question of who provides such policy guidance (an issue which will be discussed at the end of this chapter).

#### *A “two-level” definition*

As noted above and in the profile on New Zealand in Chapter 4, that country has adopted a two-level definition of charitable status, according full tax benefits to an *approved charity* and more limited tax benefits to an *approved donee organisation*. An approved donee organization can still receive tax deductible donations, but does not qualify for the other tax benefits available to approved charities, thus limiting the impact on the public treasury.

Despite the fact that adoption of a two-level definition in Canada would address concerns about runaway tax expenditures, it does have a number of disadvantages:

- \* It would likely require amendments to the *Income Tax Act* and its Regulations.
- \* It would still require interpretation by tax authorities, and a two-level definition might be just as difficult to administer as the current definition, particularly if it was not clearly drafted.
- \* Organizational complaints might not diminish, but merely shift to focus on exclusion from the “upper tier”.

**Nevertheless, this option represents a compromise that could be more workable than the current system, particularly if the definitions were clear and had full political support.**

#### *Establishment of an “arm’s length” agency to determine charitable status*

A third option for addressing the question of definition is to establish an “arm’s length” agency, somewhat similar to the Charity Commission in the United Kingdom (described in Chapter 4). Such an agency would be empowered to determine which organizations qualify as charities for income tax purposes and could also undertake other functions in support of charities, as does the U.K. Commission.

The existence of a “charity agency” would serve to distance the government from day-to-day decisions on charitable issues, much as the Canadian Radio-television and Telecommunications Agency (CRTC) does on broadcasting issues. If one can extrapolate from the British experience, the charity agency could also be expected to take a more flexible approach to the designation of charities than either Revenue Canada or the courts. (For example, the Charity Commission in the United Kingdom has recognized charities that combat racism and promote better race relations.)<sup>38</sup> It would also provide a “single window” for charities and for the general public to obtain information on tax and legal issues.

<sup>37</sup> [The Voluntary Action Directorate: Rethinking the Mandate](#), p. 14.

<sup>38</sup> [The Voluntary Action Directorate: Rethinking the Mandate](#), pp. 14-15.

On the other hand, the creation of an “arm’s length” agency to administer tax and other legal matters pertaining to charities does raise a number of potentially contentious issues.

- \* Which portfolio would house a “charity agency”? Is determination of charitable status a fiscal issue, implying that the agency should fall under the Minister of Finance? Or is it a socio-cultural issue, meaning that it should more appropriately be the responsibility of the Minister of Human Resources Development or the Minister of Canadian Heritage? Or is it simply an administrative issue for taxation purposes that should continue to fall within the purview of the Minister of Revenue?
- \* Does the federal government wish to expand the definition of charitable status to include more groups? If so, which groups? Who decides?
- \* Does the federal government wish to distance itself from policy development affecting the size, scope and composition of the “third sector”? How long should the length of the “arm” be between the charity agency and the parent department?
- \* Would rejected groups continue to have the right of appeal? If so, to whom and by what mechanisms? (Appeal to the courts might lead to a situation virtually identical to the status quo, with the courts remaining the ultimate arbiters of charity policies. However, appeal to the Cabinet, as is the situation with the CRTC, creates its own set of problems, often giving the perception of political interference.)

These are questions that can only be answered by public policy decision makers. **However, the option of creating an “arm’s length” agency on charitable matters deserves closer examination, since it goes beyond the question of defining charitable status to address many of emerging policy issues arising from government downsizing and rethinking the role of government.**

### **3) A comprehensive and coordinated approach to charitable tax policies**

A survey carried out by Statistics Canada in 1986-87 estimated that there were 5.3 million Canadians performing volunteer work. The value of this work, using the average service sector wage as a benchmark, was calculated at approximately \$12 billion (in 1987 dollars). This was equivalent to 53% of the wage bill for the entire retail industry in that year, and 43% of the total wage bill for all of Canada’s public servants, including the armed forces.<sup>39</sup>

Given the size of this “third sector” and the expectation that it will take on more of the health, education, social support and community development responsibilities of the public sector, it is somewhat surprising that there is no clear public policy centre for charities and non-profit organizations at the federal level. Currently, tax policies (which are probably the most critical determinants of charitable resource levels) are developed by the Department of Finance and administered by Revenue Canada Taxation and Revenue Canada Customs and Excise.

General fiscal and legal concerns of the voluntary sector are usually addressed by the Department of Canadian Heritage, while the policies of Health Canada and Human Resources Development Canada, responsible for social and health policy respectively, frequently have a large impact on charities working in those fields.

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<sup>39</sup> Economic Dimensions of Volunteer Work in Canada, pp. 4-5.

During Program Review, the Department of Finance and the Treasury Board Secretariat undertook a review of funding of interest groups, which focused on the nature of groups receiving public funds. More recently, concern about international terrorism has led to a greater interest in charities on the part of the security establishment and the Department of Foreign Affairs, which recently announced that “Canada has revoked the tax-exempt status of two so-called charities felt to be linked to extremist groups”.<sup>40</sup>

With so many bureaucratic players involved in this area of activity, it has been virtually impossible to develop comprehensive policies on charities, much less enforce them. While this lack of a framework may not ring alarm bells for the general population, it is of growing general concern to the business community and the senior federal bureaucracy. At a 1995 conference on “Rethinking Policy” sponsored by the Canadian Centre for Management Development, Gordon Ritchie, one of the invited panellists, offered this critique of the current policy process:

- \* Clear accountability. Who is responsible for decisions? There are too many decision makers, and they are not talking to each other.
- \* Honest policy analysis. Are analysts rewarded for telling the truth to power, or are they regarded as trouble makers or insufficiently responsive to political direction?
- \* A functioning system. Are the levers attached? Is policy direction being given, and are operating agencies implementing it?
- \* Money where the mouth is. Can you call the tune if you are not paying the piper? Resources have to be allocated in a way that reinforces decisions and priorities.
- \* Downsizing that is strategic, not cosmetic.<sup>41</sup>

While this critique refers to the policy process in general, rather than to the policy process relating to charities, it touches on many of the main problems that have emerged from this study.

Responsibility for tax policies affecting charities is fragmented. Communications between departments playing key roles appear to be limited. Those making decisions at Revenue Canada are not those accountable for developing the policies. Pressures to downsize the sector clash with pressures to expand it, as more and more of the public sector’s responsibilities are off-loaded to private sector and non-profit organizations. Finally, the main departments to which charities address their grievances -- Finance and Canadian Heritage -- do not have the resources to undertake comprehensive policy development, and are frequently at odds with each other -- the former seeking to limit charities’ access to tax benefits and the latter to open the doors wider.

**The results of this survey suggest that charitable tax policies work best in those countries with the clearest policy direction and lines of accountability and communications. The United Kingdom and New Zealand appear to have the most “transparent” systems, although it has not been possible in the course of this study to determine to what extent the organizations responsible for administration of charitable**

<sup>40</sup> Aileen McCabe and Julian Beltrame, “8 nations near deal to fight fanatics”, *The Ottawa Citizen*, July 30, 1996, p. A1.

<sup>41</sup> Gordon Ritchie, *Rethinking Policy: Strengthening Policy Capacity*. Conference Proceedings. Ottawa: Canadian Centre for Management Development, January 1996, p. 15.

tax policy (the Charity Commission and Inland Revenue) are able to influence the overall direction of tax policy. Canada has been comparatively generous in using the tax system to encourage charitable donations, but is not the most progressive country among those studied in terms of its process for granting charitable status or for monitoring the performance of charities. A clearer policy framework is also needed to guide federal decision makers in designing support measures for charities (including further changes to the tax system) and in determining which types of organizations should qualify for such support.

## 4. COUNTRY PROFILES

### CANADA

The charitable sector in Canada is large and plays a significant role in the delivery of services to Canadians. It has been estimated that approximately \$86 billion in revenues passed through registered Canadian charities in 1993, an amount equal to 12% of Canada's Gross Domestic Product in that year. Charities paid out about \$40 billion in salaries and benefits in 1993 and employed an estimated 1.32 million Canadians.<sup>42</sup> In a typical month in 1993, Canadian charities relied on the volunteer services of about 1.6 million Canadians, drawn from a total volunteer base of about 4.5 million people (although it should be noted that this base may include individuals who volunteer for more than one charity, meaning that the actual number of bodies may be somewhat lower).<sup>43</sup>

Almost half of all registered charities in Canada (45%) are classified by Revenue Canada as doing religious work. Another 16% carry out welfare activities, 15% are engaged in education, 14% provide "Other benefits to the community" and 7% are in the health care field. The remaining 3% engage in other types of activities considered charitable by the taxation authorities.<sup>44</sup>

Hospitals and teaching institutions account for almost 60% of the revenues generated by the charitable sector in Canada, even though they comprise only 5% of all registered charities. Charitable organizations (defined as those engaged in health, welfare, educational, religious and other activities) accounted for about 30% of revenues, while places of worship and foundations generated the rest. In general, the larger but less numerous charities were responsible for most of the economic activity in the sector.<sup>45</sup>

In 1993, **receipted**<sup>46</sup> donations accounted for almost 10% of the revenues of registered charities. Of the \$8.4 billion in **receipted** charitable donations made in 1993, places of worship received almost 38%. About 34% of these donations went to other charitable organizations (as defined in the preceding paragraph), while public and private foundations received approximately 19%. Teaching institutions received less than 7% of all receipted charitable donations, and hospitals received an even lower percentage -- less than 2%.<sup>47</sup> Individual donors were far more generous than corporations, contributing \$6.6 billion to registered

<sup>42</sup> Sharpe, David, *A Portrait of Canada's Charities: The Size, Scope and Financing of Registered Charities*. Toronto: Canadian Centre for Philanthropy, 1994, pp. 13-14.

<sup>43</sup> *A Portrait of Canada's Charities: The Size, Scope and Financing of Registered Charities*, p. 42.

<sup>44</sup> *A Portrait of Canada's Charities: The Size, Scope and Financing of Registered Charities*, p. 5.

<sup>45</sup> *A Portrait of Canada's Charities: The Size, Scope and Financing of Registered Charities*, pp. 15-16.

<sup>46</sup> Donations where a receipt was issued to the donor for income tax purposes.

<sup>47</sup> *A Portrait of Canada's Charities: The Size, Scope and Financing of Registered Charities*, p. 23.

charities in 1993, as compared to only \$1 billion by corporations.<sup>48</sup>

An important contextual point to keep in mind when reviewing the information below on the tax status of Canadian charities is that **unreceipted** donations<sup>49</sup> amounted to approximately \$2 billion of registered charity revenues in 1993 -- almost one-fifth of all donations in that year. In addition, a substantial proportion of receipted donations appear not to be claimed for tax purposes. For example, in 1993, it has been estimated that tax credits were issued for only about \$3.5 billion of the \$6.6 billion donated by individuals to charities.<sup>50</sup>

The cost to the federal treasury of extending tax benefits for charities includes not only the concessions granted to charities through the *Income Tax Act*, but also through the Goods and Services Tax. (The Goods and Services Tax (GST) is a federal value-added sales tax of 7% which applies to all goods and services sold in Canada, with certain limited exceptions.) The total estimated tax expenditures for 1990, 1991, 1992 and 1993 (the latest years available) are as follows:<sup>51</sup>

<b>Government of Canada Tax Expenditures for Charitable Purposes</b>				
<b>Type of Expenditure</b>	<b>1990</b>	<b>1991</b>	<b>1992</b>	<b>1993</b>
<b>Personal Income Tax</b>				
Charitable Donations Credit	not available	\$845 million	\$865 million	\$880 million
Gifts to the Crown	not available	\$22 million	\$17 million	\$14 million
<b>Corporate Income Tax</b>				
1 Deductibility of Itemized Charitable Donations	\$88 million	\$74 million	\$82 million	not available
2 Non-taxation of registered charities and other non-profit corporations	not available	not available	not available	not available
<b>Goods and Services Tax</b>				
	GST not yet in effect			
Rebates for charities		\$105 million	\$115 million	\$120 million
Rebates for hospitals*		\$280 million	\$280 million	\$275 million
Rebates for universities*		\$115 million	\$115 million	\$120 million
Rebates for colleges*		\$45 million	\$50 million	\$50 million
Rebates for non-profit organizations**		\$65 million	\$70 million	\$75 million

SOURCES: Government of Canada Tax Expenditures, December 1994 and Government of Canada Tax Expenditures, 1996.

\* Many of which are also charities.

\*\* Not registered charities, but organizations receiving at least 40% of its revenue from government sources. Organizations such as those promoting amateur athletics at the provincial or local level fall into this category.<sup>52</sup>

<sup>48</sup> A Portrait of Canada's Charities: The Size, Scope and Financing of Registered Charities, p.22.

<sup>49</sup> Donations where a receipt was not issued to the donor for income tax purposes.

<sup>50</sup> A Portrait of Canada's Charities: The Size, Scope and Financing of Registered Charities, p. 28.

<sup>51</sup> Department of Finance, Government of Canada Tax Expenditures. December 1994, pp. 23, 26, 27 and 42.

<sup>52</sup> GST - Goods and Services Tax: Completion Guide and Form for Registrant Public Service Bodies' Rebate. Revenue Canada, Customs and Excise Publication, June 1992.

## DEFINITION OF CHARITABLE STATUS

The legal definition of a “charity” in Canada is, like that of the United Kingdom, Australia and New Zealand, based upon the “letter and the spirit and intendment” of the Preamble to the *Statute of Charitable Uses 1601*, as interpreted by the courts.

The Charities Division of Revenue Canada administers the *Income Tax Act* as it applies to registered charities. In assessing applications for charitable status from organizations, Revenue Canada applies the following standards:

- \* The organization must be operated for charitable purposes, defined as one or more of the following:
  - \* the relief of poverty
  - \* the advancement of religion
  - \* the advancement of education, including:
    - establishing and operating schools, colleges, universities and similar institutions
    - establishing academic chairs and lectureships
    - providing scholarship, bursaries and prizes for scholastic achievement
    - undertaking research in a recognized field of knowledge
    - advancing science and scientific institutions
    - providing and maintaining museums and public art galleries
  - \* of benefit to the community, such as:
    - providing relief to victims of natural disasters
    - relieving suffering or disability caused by old age
    - preventing and relieving sickness and disability, both physical and mental
    - providing rental housing for people with special needs
    - preserving the environment
    - protecting the welfare of children
    - providing counselling services for people in distress
    - rehabilitating victims of substance abuse
    - providing public amenities to benefit the community
    - establishing safety or rescue operations
    - establishing humane societies and similar institutions to prevent cruelty to animals
- \* The organization must be resident in Canada.
- \* The organization cannot have any income payable to benefit its members.
- \* The charity must meet a public benefit test, showing that its activities provide a tangible benefit to the public, that the public as a whole or a significant section of it are eligible for benefits and that its activities are legal and not contrary to public policy.<sup>53</sup>

Revenue Canada recognizes two types of registered charities:

- 1) **Charitable Organizations** - defined in legislation as registered charities that primarily carry out their own charitable activities and where less than 50% of the directing officers are related persons and at least 50% of revenues are received from donors that are not related persons. Charitable organizations can be corporations or established by a constitution or trust document.

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<sup>53</sup> Registering Your Charity for Income Tax Purposes. Revenue Canada Publication T4063, 1994, pp. 4-8. (Also available at Worldwide Web Site - <http://www.revcan.ca/E/pub/gd/406394e/406394e.txt.html>.)

- 2) **Charitable Foundations** - defined in legislation as a public or private foundation, established either as a trust or a corporation.
- \* A public foundation is a charity with a primary purpose to fund other organizations that are qualified donees. Less than 50% of directing officers are related persons and at least 50% of revenues are received from donors who are not related persons.
  - \* A private foundation is a closely held charity that carries on its own activities or funds other organizations that are qualified donees. More than 50% of directing officers are related persons and more than 50% of its revenues are from one person or a group of related persons.<sup>54</sup>

A “qualified donee” under the *Income Tax Act* is an entity to which a Canadian resident can make a tax-assisted donation. It should be noted that not all of these organizations fall into the category of “registered charity”, as defined above, but have been designated specifically in the *Income Tax Act* to encourage support for activities that have been deemed by the government of the day to further public policy objectives. Therefore, “qualified donees” include:

- \* registered charities
- \* registered **Canadian** amateur athletic associations (provincial and local amateur athletic associations are excluded under this definition)
- \* housing corporations resident in Canada and exempt from tax because they are constituted exclusively to provide low-cost accommodation to the elderly
- \* Canadian municipalities
- \* the United Nations or agencies thereof
- \* universities outside of Canada the student body of which ordinarily includes students from Canada
- \* charitable organizations outside of Canada to which Her Majesty in right of Canada has made a gift in the past tax year or in the 12 months immediately preceding the tax year
- \* Her Majesty in right of Canada
- \* Her Majesty in right of a province
- \* registered national arts service organizations.<sup>55</sup>

Organizations **ineligible** to apply for charitable status under the *Income Tax Act* are:

- \* organizations whose incomes provide personal benefit to trustees or shareholders
- \* organizations that engage in political activities, such as furthering the aims of a political party or promoting a political doctrine (although charities are allowed to engage to a limited extent in non-partisan political activities that directly help accomplish the charity’s purposes, such as distributing publications)
- \* service clubs established primarily to hold social events for their members
- \* organizations set up to help named individuals or private groups.<sup>56</sup>

For purposes of the Goods and Services Tax (GST), a charity is defined as “an organization or amateur athletic association that has a charitable registration number, allowing it to issue receipts for income tax purposes”.<sup>57</sup> Under proposed amendments to the *Excise Tax Act*, the

<sup>54</sup> [Registering Your Charity for Income Tax Purposes](#), p. 11.

<sup>55</sup> [Information for Registered Charities - 1995 - Your Guide to the Registered Charity Information and Public Information Return Form \(Form T3010\)](#). Revenue Canada Publication T4033, 1995, p. 21. (Also available on Worldwide Web site - <http://www.revcan.ca/E/pub/gd/403395e/403395e.txt.html>.)

<sup>56</sup> [Registering Your Charity for Income Tax Purposes](#), pp. 8-9.

<sup>57</sup> [GST - Goods and Services Tax: Basic Information for Charities](#). Revenue Canada, Customs, Excise and Taxation Publication R-3202, February 1994, p. 1.

definition of a charity for GST purposes is to be amended to exclude the following organizations:

- \* school authorities
- \* public colleges
- \* universities
- \* hospital authorities
- \* local authorities deemed to be municipalities.

Under the amended legislation, which is to take effect on January 1, 1997, these organizations will be defined as public institutions, for which there will be differing exemption rules from those applying to charities.<sup>58</sup>

## TAX TREATMENT OF CHARITIES AND DONORS

### *Charities*

In Canada, there are a number of tax benefits attached to registered charitable status besides eligibility to issue receipts for tax deductible charitable donations:

- \* Charities are exempt from income tax on all non-business income, including donations, grants and contributions, investment and property income, and on all income from a “related business” (defined as “one that directly accomplishes the charitable purposes set out in the charity’s governing documents” or “a business carried on by the charity in which substantially all of the employees are not remunerated”).<sup>59</sup>
- \* Charities are exempt from municipal property taxes in most provinces.<sup>60</sup>

Charities also qualify for a number of benefits under the federal Goods and Services Tax (GST). As of April 23, 1996, charities that are considered “small suppliers” with total revenues from **taxable activities** of \$50,000 or less or gross revenues of \$250,000 or less are not required to register under the GST.<sup>61</sup> Most charities do not have to register for the GST because most of the goods and services they provide are considered **GST-exempt**. (Examples of such services include research, counselling and education services, advertising, short-term accommodation, sales of used and donated goods and fees for library cards.) However, registration may be to a charity’s advantage in certain instances, particularly if it wishes to recover the GST paid on purchases that the charity uses to provide **taxable goods or services**.

**Registered charities** qualify for the following benefits with regard to the Goods and Services Tax (GST):

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<sup>58</sup> GST Changes for Charities. Revenue Canada Fact Sheet, April 23, 1996. (Also available on Worldwide Web Site: <http://www.revcan.ca/whatsnew/960423/english/charity.htm>.)

<sup>59</sup> 1995 - Your Guide to the Registered Charity Information and Public Information Return. Revenue Canada Publication T4033, p. 22.

<sup>60</sup> Sheila A. McClean, Rona Kluger and Robert Henery. Charitable Contributions in the OECD: A Tax Study. Alexandria, Virginia: Interphil, 1990, p. 28.

<sup>61</sup> GST - Goods and Services Tax: Basic Information for Charities, pp. 4-5. Prior to April 23, 1996, the “small supplier threshold” was revenues of \$30,000 or less from taxable activities or gross revenues of \$175,000 or less. (See GST Changes for Charities, <http://www.revcan.ca/whatsnew/960423/english/charity.htm>. for explanation of new thresholds.)

- \* An **input tax credit** of up to 100% on purchases used to provide **taxable** (including zero-rated) goods and services.<sup>62</sup> (Such **taxable goods and services** may include fees for adult fitness classes, catering services for private functions or short-term rental of facilities. **Zero-rated goods and services** include basic groceries, any goods that are exported, prescription drugs and medical devices.)<sup>63</sup>
- \* an **input tax credit** for any capital property (such as land, buildings, cars, computers, etc.) used by a charity for **taxable** activities (for example, a cafeteria used by individuals other than the charity's primary clients).<sup>64</sup>

In addition, **all** charities, whether registered or not, may apply for a **rebate of 50%** of the GST paid on purchases used in activities for which **no** input tax credit has been claimed (for example, office supplies used in carrying out the charity's work). This rebate is particularly useful for charities that are not registered under the GST and are consequently unable to obtain an input tax credit. Charities have up to four years to claim the 50% rebate.<sup>65</sup>

The GST does not apply to any grants, subsidies or donations received by a charity.<sup>66</sup> In addition, the following activities performed by **all charities**, whether or not they are registered for the GST, are **exempt under the GST**:

- \* goods or services where the work is performed primarily by volunteers (generally 90% or more)
- \* goods and services sold for an amount equal or less than their direct cost<sup>67</sup>
- \* food, beverages or short-term accommodation provided to relieve poverty, suffering or the distress of individuals (for example, soup kitchens)
- \* the sale of rights to play or participate in a casino, bingo or raffle
- \* amateur performances where all or substantially all of the performers, athletes or competitors are not paid
- \* supervised instructional classes or activities provided primarily to children 14 years of age or younger
- \* recreational programs provided for mentally or physically disabled or underprivileged individuals of any age
- \* membership services, except where members receive free or discounted admissions to museums, theatres or recreational complexes or if they entitle individuals to receive athletic or recreational instruction or use recreational facilities.<sup>68</sup>

In April 1996, the federal government indicated that it will replace the volunteer exemption for charities as of January 1, 1997 with a new provision which will exempt from the GST any goods and services that charities provide in the course of fund-raising activities. However, the new

<sup>62</sup> GST - Goods and Services Tax: Basic Information for Charities, p. 7.

<sup>63</sup> GST - Goods and Services Tax: Basic Information for Charities, pp.2-3. However, under proposed legislation introduced in April 1996, catering and short-term rental of facilities by charities are to become **exempt** services under the GST, as of January 1, 1997.

<sup>64</sup> GST - Goods and Services Tax: Information for Charities. Revenue Canada Publication CH-2: 1990, pp. 30-31.

<sup>65</sup> GST - Goods and Services Tax: Basic Information for Charities, pp. 9-10.

<sup>66</sup> GST - Goods and Services Tax: Basic Information for Charities, p. 13.

<sup>67</sup> GST - Goods and Services Tax: Basic Information for Charities, p. 12. However, in April 1996, the government proposed that this exemption be changed to apply only when a charity sells goods (but not services) at an amount **less** than the purchase price. (See GST Changes for Charities, <http://www.revcan.ca/whatsnew/960423/english/charity.htm>.)

<sup>68</sup> GST - Goods and Services Tax: Basic Information for Charities, pp. 12-13.

exemption will apply only to one-off activities and will not be available to charities that carry out fund-raising throughout the year through such activities as tee-shirt sales. In addition, if the donor receives a benefit throughout the year as part of the fund-raising activity (for example, amagazine subscription), the exemption will not apply.<sup>69</sup>

## **Donors**

The *Income Tax Act* encourages taxpayers to support the activities of registered charities by allowing a deduction from income for gifts made to registered charities and other qualified donees, if official receipts are obtained. A “gift” for purposes of the *Act* is defined as a “voluntary transfer of property without valuable consideration”. A gift must be in the form of cash or property. The donation of services does not qualify within this definition.<sup>70</sup> Other contributions that **do not qualify** as “gifts” include:

- \* payment of a basic fee for admission to an event or program (unless the event is a dinner, ball, concert or show organized as part of a fund-raising campaign, in which case only the portion of the admission price that is greater than the fair market value of the dinner, entertainment, etc. is considered a tax deductible “gift”)
- \* payment of membership fees that entitle the member to attend events, receive literature or services or other material benefits
- \* lottery tickets or other chances to win a prize
- \* payments for goods and services received from a charity (except for the payment of certain tuition fees to religious schools)
- \* gifts directed to a person designated by the donor
- \* gifts directed to a foreign affiliate or foreign charity (except for certain foreign charities to which the federal government (“Her Majesty in right of Canada”) made a gift in the calendar year or the preceding calendar year or U.S. charities, if the donor lived near the Canada-U.S. border, commuted to employment in the U.S., and derived most of his or her income from a business or employment in the U.S.)<sup>71</sup>

**Tax credits** by individuals and **tax deductions** by corporations can be claimed for:

- \* **donations to a registered charity or other qualified donee:**
  - **for individuals**, a tax credit of 17% on the first \$200 donated and of 29% on the balance over \$200 in any tax year
  - **for corporations**, a deduction from taxable income of the corporation equal to the total of the amount donated
- \* **gifts to Canada, a province or a territory**
  - **for individuals**, a tax credit for full amount of the gift
  - **for corporations**, a deduction from taxable income of the total of the fair market value of the gift
- \* **gifts of cultural property**
  - **for individuals**, a tax credit on the fair market value of the property donated
  - **for corporations**, a deduction from taxable income of the fair market value of the property donated

<sup>69</sup> [GST Changes for Charities](http://www.revcan.ca/whatsnew/960423/english/charity.htm), Worldwide Web Site: <http://www.revcan.ca/whatsnew/960423/english/charity.htm>.

<sup>70</sup> [IT110R2 - Deductible Gifts and Official Donation Receipts](#). Revenue Canada Income Tax Bulletin: May 14, 1986, paragraph 3.

<sup>71</sup> [IT110R2 - Deductible gifts and official donation receipts](#), paragraph 16.

- **for artists**, a tax credit on the fair market value of the work donated (which is treated as a donation from inventory, rather than a gift of capital property)

(For both individuals and corporations, the property must be certified by the Canadian Cultural Property Export Review Board (CCPERB) as being of outstanding significance and national importance and must be donated to an institution designated by the Minister of Canadian Heritage. Unlike other donations of capital property, the donor does **not** have to pay tax on any capital gains realized from such certified donations of cultural property. Artists may also donate works to designated institutions from their inventory, but must also get a certificate from the CCPERB.)

\* **gifts of ecologically sensitive land**

- **for individuals**, a tax credit on the full value of ecologically sensitive land donated after February 27, 1995
- **for corporations**, a deduction from taxable income of the fair market value of the property donated

(For both individuals and corporations, the property must be certified by the Minister of the Environment as important to the preservation of Canada's environmental heritage and must be donated to a Canadian municipality or a registered charity designated by the Minister of the Environment.)

\* **gifts of capital property**

- **for individuals**, a tax credit on an amount chosen by the donor that is between the property's fair market value (FMV) and its adjusted cost base (ACB)
- **for corporations**, a deduction from taxable income equal to an amount chosen by the donor that is between the property's FMV and its ACB.  
(However, both individual and corporate donors must report any capital gain or loss on the property donated and pay tax on any capital gain.)<sup>72</sup>

The annual limit on charitable donations was 20% of net income, but in the Federal Budget tabled by the Minister on Finance on March 6, 1996, this limit was to be increased to 50% (pending legislative amendments) for both individuals and corporations.<sup>73</sup> The 50% limit is to be further increased by 50% of the taxable capital gain resulting from the donation of appreciated capital property to a registered charity. In addition, the limit will be increased to 100% for testamentary bequests to charities.<sup>74</sup>

It should be noted, however, that no annual limits apply to the donation of gifts to Canada, a province or a territory, gifts of ecologically sensitive land or gifts of cultural property.<sup>75</sup>

<sup>72</sup> Gifts and Income Tax. Revenue Canada Publication P113E: February 20, 1996. (Also available on Worldwide Web Site: <http://www.revcan.ca/~paulb/pamphlet/p113e.htm>), and Sections 110.1 to 110.3 of the *Income Tax Act, Part 1*, R.S.C. 1985 (5th supp.) c.1. as amended and consolidated to July 20, 1995.

<sup>73</sup> Information on application to both individual donors and corporations provided verbally by Lucy Brickman, Tax Legislation Division, Department of Finance, July 17, 1996.

<sup>74</sup> Department of Finance, Budget Plan, Including Supplementary Information and Notices of Ways and Means Motions. Ottawa: Department of Supply and Services, Canada Communications Group, March 6, 1996, p. 70.

<sup>75</sup> Gifts and Income Tax.

Business sponsorships are not considered as “gifts” under the *Income Tax Act*, where a donation is made in return for a material benefit, such as advertising for the donor’s business.<sup>76</sup> Normally, the GST would not apply on a sponsorship of this nature, since the provision of advertising services by a charity is considered an exempt activity.<sup>77</sup>

## PROCESS FOR GRANTING CHARITABLE STATUS

All organizations wishing to register for charitable status under the *Income Tax Act* must apply to the Charities Division of Revenue Canada, submitting an “Application for Income Tax Registration for Canadian Amateur Athletic Associations and Canadian Charities”. Official copies of the following documents are also required:

- \* For an incorporated applicant, the certificate of incorporation, letter patent, or memorandum of incorporation.
- \* For an unincorporated applicant, the constitution or trust document bearing the original signatures of at least three of the current directing officers.
- \* For divisions of existing charities, a letter of affiliation signed by an executive officer of the principal charity and a resolution signed by officers of the applicant organization indicating that they will abide by the governing document of the principal charity.
- \* The by-laws of the organization bearing the signatures of at least two of the current directing officers.

To avoid possible problems, the Charities Division of Revenue Canada also recommends that charities submit documentation for its review **before** incorporation to ensure that objectives express specific charitable intentions.

Organizations denied charitable status have 60 days to appeal to Revenue Canada. If refusal is confirmed, the applicant has 30 days to appeal to the Federal Court of Appeal.<sup>78</sup>

All registered charities must submit an annual return -- Form T3010, the “Registered Charity Information Return and Public Information Return” -- to Revenue Canada within six months after the end of the charity’s taxation year. The return must include all relevant confidential schedules and financial statements, including separate financial statements for each related business. With the exception of the confidential schedules and financial statements, information from this return can be made available to the public. Failure to submit an annual return can result in the revocation of the organization’s charitable status.<sup>79</sup>

Charities that are required or wish to register under the GST must submit a separate application to Revenue Canada Excise. As indicated above, charities with total annual sales from taxable goods and services exceeding \$50,000 or with gross revenues greater than \$250,000 annually are required to register. Charities below these thresholds may still register voluntarily if they wish to claim input tax credits.

Once registered, charities, like all other organizations, are required to collect the GST on their sales of taxable goods and services and to file a GST return to Revenue Canada Excise for

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<sup>76</sup> IT297R2 - Gifts in Kind to Charity and Others. Revenue Canada Income Tax Bulletin: March 21, 1990, paragraph 8.

<sup>77</sup> GST - Goods and Services Tax: Information for Charities, pp. 25-26.

<sup>78</sup> Registering Your Charity for Income Tax Purposes, pp. 10-12.

<sup>79</sup> 1995 - Your Guide to the Registered Charity Information and Public Information Return, p. 4.

each reporting period.<sup>80</sup> Before April 23, 1996, reporting periods were assigned by Revenue Canada Excise at the time of registration, based upon the charity's annual volume of taxable sales. However, after that date, charities can elect a monthly, quarterly or yearly reporting period regardless of revenue levels.<sup>81</sup>

Charities that are **not** registered under the GST can file claims for rebates every six months.<sup>82</sup>

## UNITED STATES

The historical roots of philanthropy in the United States date back to the earliest colonists and have been shaped, perhaps more than in other countries, by the traditions of independence and self-reliance reflected in the US Constitution. As the historian Daniel Boorstin has observed, "communities existed before governments were there to care for public needs".<sup>83</sup> In addition, huge pools of wealth accumulated by 19th century capitalists were directed to private foundations which, in turn, have played a key role in American philanthropy. Because of the unparalleled size and extent of foundation activity in the United States, all international comparisons of private sector giving must be made with caution. (For example, the Ford Foundation, with assets of \$6.9 billion, dwarfs the \$4 billion held by all 950 Canadian foundations combined.)<sup>84</sup> American reliance upon voluntary solutions to social problems or voluntary operation of social institutions, such as hospitals, museums, libraries and universities, has been encouraged in part by the tax system, which has been characterized as being "both broad and vague".<sup>85</sup>

In 1994, total philanthropic giving by individuals, corporations and foundations amounted to \$129.88 billion,<sup>86</sup> and a recent study in the U.S. suggested that if deductibility of contributions were eliminated, this total would have been billions less.<sup>87</sup> Individuals contributed 88% of this amount or \$114 billion, foundations contributed 7.6% or \$8.77 billion and corporations accounted for only 4.7% or \$6.11 billion of charitable donations in 1994.

The "broadness and vagueness" of the tax system has, at any rate, permitted a relatively flexible approach in the United States to official definitions of the public interest, as driven by changing public needs. Patterns of giving in the U.S. reflect the broad sweep of philanthropy in that country.

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<sup>80</sup> GST - Goods and Services Tax: Information for Charities, p. 38.

<sup>81</sup> GST Changes for Charities, Worldwide Web Site: <http://www.revcan.ca/whatsnew/960423/english/charity.htm>

<sup>82</sup> GST Changes for Charities, Worldwide Web Site: <http://www.revcan.ca/whatsnew/960423/english/charity.htm>

<sup>83</sup> Quoted by Maurice G. Gurin and Jon Van Til in "Philanthropy in Its Historical Context", Critical Issues in American Philanthropy (Ed. Jon Van Til and associates). San Francisco: Jossey-Bass Publishers, 1990, p.6.

<sup>84</sup> Information derived from Don Mc Rae, Manager, Voluntary Action, Department of Canadian Heritage.

<sup>85</sup> "Philanthropy in Its Historical Context", p.11.

<sup>86</sup> John McIlquham, "Giving Flattened by Inflation", The Non-Profit Times. July 1995. (Also available at Worldwide Web Site: <http://haven.ios.com/~nptimes/July95/july02.html>.)

<sup>87</sup> Allan R. Clyde, "Tax Incentives", Foundation News & Commentary, (March-April 1996), p. 7.

## U.S. CHARITABLE DONATIONS 1994<sup>88</sup>

<u>Recipient Type</u>	<u>Amount (billions \$A)</u>	<u>% of all Donations</u>
<b>Religious Organizations</b>	<b>58.87</b>	<b>45.3</b>
<b>Educational Organizations</b> (incl. libraries, alumni associations, scholarship funds)	<b>12.35</b>	<b>9.5</b>
<b>Health Organizations</b>	<b>11.53</b>	<b>8.8</b>
<b>Human Service Organizations</b> (incl. Red Cross, disaster relief funds)	<b>11.71</b>	<b>9.0</b>
<b>Arts, Culture and Humanities</b>	<b>9.68</b>	<b>7.4</b>
<b>Public Benefit Organizations</b> (incl. civil rights groups, community development coalitions, "in kind" organizations, scientific associations, public affairs and consumer groups, alternative workplace funds)	<b>6.05</b>	<b>4.7</b>
<b>Environmental Organizations</b>	<b>3.5</b>	<b>2.7</b>
<b>International Affairs Organizations</b>	<b>2.21</b>	<b>1.7</b>
<b>Unclassified Organizations</b>	<b>13.98</b>	<b>11.0</b>

**Giving USA** indicates that one of the fastest-growing types of charity in the U.S. is "in kind" organizations, which are organizations that provide linkages between companies wishing to donate products (such as used computers) and charitable or non-profit organizations (such as schools or disaster relief funds) that have critical needs.<sup>89</sup> This growth appears to be an anomaly in the light of recent trends toward lower rates of giving to charity overall. For example, the President's Committee on the Arts and Humanities, in a recent report, indicated that in 1994, for the first time since 1985, total giving fell below 2% of GDP. Between 1987 and 1994, corporate giving declined by one-sixth in real terms -- a troublesome trend for the arts and heritage sector in the U.S., which has seen recent cuts of 39% and 17% respectively in the government appropriations of the National Endowment for the Arts and the Institute of Museum Services. The same report indicated that while total contributions to the arts were holding steady, the average size of donation per contributing household fell dramatically between 1987 and 1993.<sup>90</sup>

### DEFINITION OF CHARITABLE STATUS

In the United States, section 501(c)(3) of the *Internal Revenue Code 1994* defines a non-profit, charitable organization as:

<sup>88</sup> Giving Flattened by Inflation".

<sup>89</sup> Giving Flattened by Inflation" and Gifts in Kind International Home Page (Worldwide Web Site: <http://www.cais.com/Product/Donations/cer.html>).

<sup>90</sup> Nina Kressner Cobb, Looking Ahead: Private Sector Giving to the Arts & Humanities: Summary of Research. Worldwide Web Site: <http://spot.colorado.edu/finkelst/pres.htm>.

(3) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, testing or public safety, literary, or educational purpose, or to foster national or international amateur sports competition (but only if no part of its activities involve the provision of athletic facilities or equipment), or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation (except as otherwise provided in subsection (h), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf (or in opposition to) any candidate for public office.

Tax benefits are not, however, available to those who make contributions to foreign organizations meeting this definition. Individuals and partnerships, whether domestic or foreign, are also excluded, as are political parties, political activist groups, some lobby groups, chambers of commerce and social clubs.

## TAX TREATMENT OF CHARITIES AND DONORS<sup>91</sup>

### *Charities*

A number of benefits derive from qualification as a charitable organization or institution:

- \* Income from charitable contributions is exempt from US income tax.
- \* Restrictions are not placed on the types of gifts or donations which charitable organizations and private foundations may receive without being subject to tax liability. (It should be noted, however, that donations of property other than money or securities valued over \$5,000 must be accompanied by a qualified appraisal.)
- \* Tax-exempt organizations may obtain partial tax exemption from some state and local income, property or sales taxes.
- \* A charitable organization can benefit from corporate matching programs, which are fairly common in the US. Under these programs, an employer matches employee donations to a registered charity.

Certain restrictions also apply:

- \* An excise tax is applied to the net investment income of certain private foundations.
- \* Tax-exempt organizations that are not classified as foundations may be subject to corporate income tax on their unrelated business income.
- \* Private operating foundations (those which use funds to carry out their stated charitable goals) must distribute at least 85 per cent of their income for the activity for which they are organized.
- \* Private non-operating foundations (those which make grants for any charitable purpose) must distribute all of their income annually. Undistributed income is subject to income tax.

### *Donors*

Contributions to qualified charitable organizations confer a number of benefits to the donor, who may be an individual, a corporation, an estate or a trust:

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<sup>91</sup> Much of the information in this section of each of the country profiles is summarized from Sheila A. McClean, Rona Kluger and Robert Henery. *Charitable Contributions in the OECD: A Tax Study*. Alexandria, Virginia: Interphil, 1990.

- \* Individuals and corporations are allowed an income tax deduction based on the amount of their contribution to a charity or private foundation, subject to the following ceilings:

*Individuals*

- gifts to charities and private operating foundations - 50 per cent of adjusted gross income (except for gifts of capital property to which a 30% limit applies)
- gifts to private non-operating foundations, veterans' organizations, fraternal societies and non-profit cemeteries - 30 per cent of adjusted gross income (except for gifts of long-term capital gain appreciated property, which are subject to a 20 per cent ceiling)<sup>92</sup>

*Corporations*

- gifts to charitable organizations - up to 10 per cent of net income (excess may be carried forward for five years)

- \* Charitable contributions include:

- Money or property given to:
  - \* churches, synagogues, temples, mosques and other religious organizations
  - \* federal, state and local governments
  - \* non-profit schools and hospitals
  - \* public parks and recreation facilities
  - \* benevolent organizations such as the Salvation Army, Red Cross, the Boy and Girl Scouts
  - \* war veterans' groups
- Costs paid for a student living with the donor, if the student is sponsored by a qualified organization
- Out-of-pocket expenses incurred by the donor as a result of serving a qualified organization as a volunteer.<sup>93</sup>

- \* Income tax deductions for non-cash contributions over \$5,000 are permitted to the extent of the property's fair market value at the time of the gift, provided that a qualified appraisal is prepared. Different rules apply depending on whether the property is considered **ordinary income property** or **capital gain property**.

**Ordinary income property** may include such things as works of art or manuscripts created by the donor. The amount that can be deducted is the property's fair market value less the amount that would be ordinary income or short-term capital gain if the property were sold for its fair market value.

**Capital gain property** may include stocks, bonds, jewellery, coin or stamp collections or cars or furniture used for personal purposes. The amount that can be deducted is usually the property's fair market value, but in certain situations (such as if the property is donated to a private, non-operating foundation) the fair market value must be reduced by an amount that would have been long-term capital gain if the property had been sold at its fair market value.<sup>94</sup>

- \* Charitable contributions, including property, are exempt from the US gift tax and can be used as deductions against estate taxes.
- \* Tax benefits are permitted for contributions to domestic charitable organizations that conduct charitable activities in other countries.

<sup>92</sup> Internal Revenue Service, Charitable Contributions. Publication 526: Catalogue No. 15050A, 1994, p.9.

<sup>93</sup> Charitable Contributions, p. 2.

<sup>94</sup> Charitable Contributions, p.8.

- \* Although no deduction is permitted for the donation of services to a charitable organization, out-of-pocket expenses are deductible. The following out-of-pocket expenses qualify:
  - expenses to allow underprivileged youth to attend athletic events, films, etc.
  - convention meal and lodging expenses if the donor is a chosen representative of a qualified organization
  - uniforms required when performing work for a charitable organization
  - some expenses of being a foster parent
  - some expenses incurred as a church deacon
  - car expenses directly related to services provided for a charitable organization
  - travel expenses incurred while performing services away from home for a charitable organization.<sup>95</sup>

The following restrictions on donor tax benefits apply:

- \* The donor cannot derive an economic benefit from a gift or contribution to a charitable organization.
- \* No tax benefits are permitted for donations to charities created or organized outside the United States, except when a U.S. charity controls the funds or if the donation is given to certain Canadian and Mexican charities covered under income tax treaties with the U.S.<sup>96</sup>

## PROCESS FOR GRANTING CHARITABLE STATUS

Organizations must file applications for tax-exempt status with the Internal Revenue Service (IRS). The IRS makes two determinations:

- 1) whether the organization can be recognized as tax-exempt under the *Internal Revenue Code*, subsection 501 (a), which states:

***Exemption from taxation.*** An organization described in subsection c) or d) or section 401 a) shall be exempt from taxation under this subtitle unless such exemption is denied under section 502 or 503. (The latter sections deal with feeder organizations and requirements for exemption respectively.)

- 2) whether it is eligible to attract charitable contributions that are deductible by donors for tax purposes. (Certain organizations that are tax-exempt, such as social clubs or fraternal lodges, are not eligible for tax deductible charitable contributions.)

In general, if the organization meets the requirements stipulated in the *Internal Revenue Code*, a tax exemption is granted, but a new application is required if the organization's legal status changes. Every organization that is tax-exempt, except churches and those with receipts of less than \$25,000 annually, must file an annual information return with the IRS.

The Internal Revenue Service maintains Publication 78, a cumulative list of organizations eligible to receive tax deductible contributions. An organization can be removed from this listing (which runs to the size of two big-city phone books) if it does not file the annual "Return of Organizations Exempt from Income Tax", effectively curtailing the charity's ability to raise funds

<sup>95</sup> Charitable Contributions, p.5.

<sup>96</sup> Charitable Contributions, p.3 and p.5.

from the general public.<sup>97</sup>

## UNITED KINGDOM

The English Common Law tradition (including the case law flowing from it) has been the basis upon which most major English-speaking nations have developed their tax treatment of charities. The Preamble to the Elizabethan *Statute of Charitable Uses 1601* set out a list of matters considered to be “charitable”, which has since been used as an index by the courts to determine whether particular activities qualify for tax benefits. The *Pemsel* case, cited in Chapter One of this report, is perhaps the most famous and widely quoted of these decisions.

Under English Common Law, in order to be considered charitable, the purpose of an organization must meet four tests:

- 1) it must fall within one of the four categories listed in the *Pemsel* case;
- 2) it must confer a tangible benefit on the public;
- 3) it must fall within the “letter or the spirit and intendment” of the Preamble to the *Statute of Charitable Uses 1601*;
- 4) it must not work against public policy, which has been interpreted as meaning that the charity must demonstrate:
  - a) an absence of “self help”
  - b) an absence of profit distribution
  - c) an absence of substantial political element
  - d) an absence of related non charitable purposes.<sup>98</sup>

In the United Kingdom, *The Charities Act, 1960* established a body known as the Charity Commissioners, charged with “promoting the effective use of charitable resources by encouraging the development of better methods of administration, by giving charity trustees information or advice on any matter affecting the charity, and by investigating and checking abuses.”<sup>99</sup> In 1992 and 1993, *The Charities Act* was updated to extend the Charity Commission’s powers to control of fund raising for charitable institutions and to extend other functions and powers of the Commission itself.<sup>100</sup>

The Charity Commissioners are appointed by the Home Secretary and are deemed to be civil servants.<sup>101</sup> In 1995, the Charity Commission had a budget of almost 23 million pounds and a staff of 597.<sup>102</sup>

To fulfill their mandate, the Charity Commissioners have the following duties and powers:

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<sup>97</sup> Department of the Treasury, Internal Revenue Service, “Instructions for Form 990: Return of Organizations Exempt from Income Tax”, (1994) p. 2.

<sup>98</sup> This summary of English Common Law principles for determining charitable status is an extreme condensation of information contained in *Charities: The Legal Framework*, a background paper prepared by Neil Brooks for the Policy Coordination Directorate, Department of the Secretary of State, February 1983, pp. 19-24.

<sup>99</sup> *The Charities Act, 1960*, Section I (3).

<sup>100</sup> Lord Hailsham of St. Marylebone, *Halsbury’s Laws of England*, Volume 5(2). London: Butterworth’s, 1993, Para. 391, p. 253 and Para.434, p. 281.

<sup>101</sup> *Halsbury’s Laws of England*, Para. 435, p. 281.

<sup>102</sup> The Charity Commission - What did we do in 1995". Worldwide Web Site: <http://www.charity-commission.gov.uk/ccar.htm>.

- \* to maintain a central register of charities
- \* to exchange information with regard to institutions treated as charitable
- \* to make schemes (new rules for the administration of a charitable trust, particularly where ambiguity exists or when some financial impropriety has occurred)
- \* to appoint and remove trustees and officers of a trust, especially in cases where the charity is experiencing legal difficulties
- \* to make common investment schemes for charities
- \* to authorize beneficial transactions
- \* to provide advice to charity trustees
- \* to provide for the enrolment and preservation of documents belonging to charities
- \* to order the taxation (ie. review) of a solicitor's bill of costs for work done for a charity
- \* to take legal proceedings
- \* to consent to the expenditure of charity money on promoting legislation in Parliament
- \* to consent to certain dispositions of charity property
- \* to act for the protection of charities by inquiry and audit and to make orders in consequence of these investigations.<sup>103</sup>

The Charity Commission's powers extend to all charities except those identified as exempt under *The Charities Act 1993*. Exempt charities include certain major universities and colleges, grant-maintained schools, certain other educational corporations (such as the National Curriculum Council), the Boards of Trustees of a number of major museums (such as the Victoria and Albert Museum and the Museum of London), the British Library Board, the Church Commissioners, registered industrial and provident societies, and societies registered under the *Friendly Societies Act 1974*.<sup>104</sup> The Charity Commission also has no jurisdiction in Scotland and Northern Ireland.<sup>105</sup>

As of the end of 1995, there were 154,500 registered charities in the United Kingdom with a total income of about 16 billion pounds. However, as in Canada, the largest charities tend to get most of the resources. In 1995, the top 8% of charities got over 92% of the sector's income, while the smaller charities, which comprise almost 73% of the sector, received less than one-fiftieth of its total income.<sup>106</sup>

## DEFINITION OF CHARITABLE STATUS

As indicated above, there is no statutory definition of charity in the United Kingdom. Instead, the Charity Commissioners adhere to the guidelines outlined in the *Pemsel* case, namely that a charitable organization is a trust, foundation, company or unincorporated association performing one or more of the following functions:

- 1) the relief of poverty (including the elderly, young children and those with special needs)
- 2) the advancement of education
- 3) the advancement of religion
- 4) some other purpose beneficial to the community.

In addition, the "public benefit" test must be satisfied, which means that the charitable activity must be both beneficial and available to a sufficient section of the community. A "sufficient section of the community" has been interpreted by the Commissioners to include persons in a

<sup>103</sup> Halsbury's Laws of England, Para. 438, p. 283.

<sup>104</sup> Halsbury's Laws of England, Para. 290, p. 196.

<sup>105</sup> Inland Revenue, Tax Reliefs for Charities. Publication IR75, June 1987, p. 3.

<sup>106</sup> Charity Commission, "Facts & Figures". Worldwide Web Site: <http://www.charity-commission.gov.uk/ccfacts.htm>.

particular locality or of a particular religion, as well as persons in the whole of a particular industry (but not employees of a particular company).<sup>107</sup>

The word “education” is interpreted in a broad sense to cover various types of research. The word “religion” includes religious orders and communities, provided that their work is sufficiently public in nature, but generally excludes contemplative orders and sects regarded as contrary to public policy. “Purposes beneficial to the community” is interpreted to include the following:

- 1) establishing libraries, museums and recreational facilities
- 2) increasing the efficiency of the armed forces
- 3) promoting industry, commerce and the arts
- 4) protecting animals
- 5) providing social welfare.

Within the categories above, however, neither support for particular sports events nor support for the arts is considered a charitable purpose in the United Kingdom unless it is connected to the advancement of the educational system.<sup>108</sup>

Charitable corporations in the United Kingdom include such entities as colleges and hospitals, as well as other corporations created solely for the fulfilment of charitable purposes. Charitable corporations may be created by royal charter, Act of Parliament, by registration under the *Companies Acts*, and by the Charity Commissioners under the *Charities Act 1993*.<sup>109</sup> The following corporations in the United Kingdom are not considered charities, but receive the same tax relief as charities:

- \* The British Museum
- \* The Natural History Museum
- \* The National Heritage Memorial Fund
- \* The Historic Buildings and Monuments Commission for England<sup>110</sup>

Organizations which engage in political or propaganda activities or activities contrary to public policy are denied charitable status by the Charity Commissioners. New guidelines issued by the Charity Commissioners in July 1995 have clarified that “...charities can contribute to the political process ... but may only undertake those activities which further its purposes and which are authorized in its governing documents”. Permitted activities include:

- campaigning on behalf of their beneficiaries
- seeking to influence Government or public opinion
- advocating or opposing changes in the law
- supporting, opposing or promoting legislation
- providing factual information to Members of Parliament<sup>111</sup>

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<sup>107</sup> [Charitable Contributions in the OECD: A Tax Study](#), pp. 148-9.

<sup>108</sup> [Charitable Contributions in the OECD: A Tax Study](#), pp. 149-50.

<sup>109</sup> [Halsbury's Laws of England](#), paras. 214 and 217, pp. 155-6.

<sup>110</sup> [Gift Aid: A guide for donors and charities](#), p. 8.

<sup>111</sup> Political Campaigning by Charities - New Ground Rules Established”, Press Release by the Charity Commission, July 18, 1995, p. 1.

## TAX TREATMENT OF CHARITIES AND DONORS

### *Charities*

In the United Kingdom, a charity is exempt from tax on all donations from individuals, companies and other charities. The mechanism for this exemption is a refund from UK Inland Revenue of that amount of income tax deducted by the donor from his or her annual income. (This income tax deduction is based upon the donor's intended charitable donation. SEE SECTION ON DONORS BELOW.)

Other benefits that derive from charitable status include:

- \* Tax exemption on the profits from bazaars, carnivals, film shows and other fund-raising events, provided that the organization does not regularly engage in such "trading" activity, that it is not in competition with other traders and that the profits are applied for charitable purposes.
- \* Income tax exemption on the profits of a trade that is inseparable from the primary purpose of a charity (e.g. the running of a school) or that is carried out mainly by the beneficiaries of a charity (e.g. the blind or disabled), provided that the profits are applied for the purpose of the charity.<sup>112</sup>
- \* Income tax exemption on interest or dividend income derived from investments (if such income is applied to charitable purposes).
- \* Income tax exemption on capital gains realized by a charity (as long as the gain is applied for charitable purposes).
- \* Exemption from inheritance and gift taxes.
- \* **Exemption**<sup>113</sup> from the Value Added Tax (VAT) for:
  - donations, bequests and grants received by the charity
  - voluntary services provided by the charity (e.g. first aid at public functions)
  - rent from the hiring out of charity-run buildings
  - advertising in charity brochures (provided that at least 50% of the ads are from private individuals and not corporations)
  - welfare services and goods supplied by charities (e.g. for care and treatment of the disabled)
  - interest and dividends received by charities
  - sponsorships, as long as the sponsor receives no benefit such as free advertising
  - membership subscriptions, as long as members receive no benefits
  - "one-off" fundraising events held by charities for charitable purposes including:
    - admission charges
    - the sale of commemorative brochures
    - advertising in such brochures
    - other items sold at the event, such as tee-shirts

<sup>112</sup> Inland Revenue, Trading by Charities: Guidelines on the tax treatment of trades carried on by charities. Charities Series CS2: April 1995, para. 3.1.

<sup>113</sup> Exemption" from VAT means that the activity is considered "non-business" and is therefore outside the scope of VAT. Charities whose activities are wholly outside the scope of VAT may not register under VAT to recover the tax paid on non-exempt goods and services that they have purchased.

- sponsorship payments directly connected with a qualifying fundraising event<sup>114</sup>
- \* **Zero rating**<sup>115</sup> of the Value Added Tax (VAT) for:
  - non-classified charitable advertising in newspapers and other printed media for educational or fundraising purposes (including artwork and typesetting)
  - the cost of broadcasting or screening charitable advertisements on TV, radio and cinema (but not the cost of the producing the ad)
  - sales of donated goods
  - medical or scientific equipment used for medical research
  - ambulances and sea rescue equipment
  - sound recording equipment for charities caring for the blind
  - medicinal products and medical equipment used by a charity
  - supplies for the construction of buildings to be used by charities for charitable purposes (including the construction of new wings of existing buildings)<sup>116</sup>
- \* Relief of between 50 to 100 per cent of local authority rates (property taxes) for premises that are used wholly or mainly for charitable purposes.<sup>117</sup>

The definition of “charitable purposes” is fairly broad in the United Kingdom and includes:

- 1) financing of the charity’s own charitable activities
- 2) purchasing assets for use in these activities
- 3) investing money to increase a charity’s endowment
- 4) making grants to other charities
- 5) administrative and fundraising expenses.

Some restrictions apply on these benefits:

- \* Charities must take reasonable steps to ensure that payments to foreign organizations are applied for charitable purposes.<sup>118</sup>
- \* Trading activities that do not further a charity’s purpose are subject to income tax and VAT (unless the trade is carried out by a subsidiary company wholly owned by the charity which remits all its profits to the parent charity).<sup>119</sup>
- \* Charities cannot lend or invest in a manner solely for tax avoidance purposes.<sup>120</sup>

## **Donors**

Donors in the United Kingdom can derive tax relief from income tax, corporation tax, capital gains tax, gift tax and inheritance tax. However, the rules are somewhat different for individuals

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<sup>114</sup> HM Customs & Excise, Value Added Tax - Charities. VAT Notice 701/1/95, 1 January 1995, pp. 7-15 and p. 29.

<sup>115</sup> “Zero-rating” means that the VAT rate applies, but it is nil. For example, certain types of goods might normally bear VAT at the standard rate, but if they are donated and sold by a charity which uses the proceeds for charitable purposes, the VAT is set at zero.

<sup>116</sup> Value Added Tax - Charities, pp. 19-26.

<sup>117</sup> “Tax Benefits for Charities”, p. 5.

<sup>118</sup> Charitable Contributions in the OECD: A Tax Study, p. 151.

<sup>119</sup> Charitable Contributions in the OECD: A Tax Study, p. 153.

<sup>120</sup> Charitable Contributions in the OECD: A Tax Study, p. 152.

and companies.

### *Individuals*

Individuals can obtain tax relief for *cash* payments to charities through three methods -- (1) a deed of covenant, (2) a payroll deduction scheme or (3) a Gift Aid scheme.

- 1) A deed of covenant is a legal commitment made by a donor to donate a portion of income over a period of time exceeding three years. Under a deed of covenant, a taxpayer agrees to pay an amount (for example, 100 pounds) to a charity. At tax time, he deducts income tax at the basic rate (29% of the 100 pounds), but retains it and sends only the remainder (71 pounds, in this example) to the charity. The charity receives not only the donor's contribution, but can also reclaim the income tax deducted as a tax refund. Higher rate taxpayers may be able to claim extra relief, and there are no annual limits on the amount of covenanted donations by individuals.
- 2) Tax relief can be obtained for uncovenanted contributions through a payroll deduction scheme, but such donations are limited to 120 pounds per annum.
- 3) Through a Gift Aid scheme, introduced in October 1990, both individuals and companies are able to obtain tax relief for individual, non-covenanted donations to charities. The minimum qualifying gift is 250 pounds, net of basic rate income tax, and the donor must have at least as much income charged at the basic rate of taxation as the amount of the gross donation. However, there are no restrictions on the number of separate 250 pound gifts a donor may make in a single tax year.

If the donor receives benefits totalling more than 2.5% of the net gift, the donation will not qualify for Gift Aid, and total benefits received from any one charity must not exceed 250 pounds in any year. Gifts must also be cash payments: donation of goods worth more than 250 pounds (for example, works of art) does not qualify for Gift Aid tax relief.<sup>121</sup>

### *Corporations*

Corporations can receive tax relief for *cash* payments to charities through 1) a deed of covenant, 2) a sponsorship payment or 3) a Gift Aid scheme.

- 1) Under a deed of covenant (which works the same way as described above), corporations can donate up to 3 per cent of the amount of dividends it pays out annually. A company making a covenanted payment deducts income tax at the basic rate and pays it to UK Inland Revenue. The charity can then reclaim this tax as a refund.
- 2) A payment can be made to sponsor a charitable activity, provided that the payment is not of a capital nature and if the sole purpose of the business is to get publicity for its name or product. Under certain circumstances a *single* charitable payment that does not qualify as a sponsorship may be eligible to similar tax relief as for covenanted payments.
- 3) The Gift Aid guidelines for companies are similar to those described above for individuals.

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<sup>121</sup> Inland Revenue, Gift Aid: A guide for donors and charities. Charities Series IR113: July 1994, pp. 2-7.

In all cases, tax relief is calculated by deducting the amount of the charitable donation from the company's profits.<sup>122</sup>

- \* *Non-cash* donations by individuals, such as land or stocks, may also be made under a deed of covenant. No independent appraisal of the worth of these donations is required, and gifts of land or investments are not subject to capital gains tax when given to a charity.
- \* Gifts of assets by companies are not tax deductible (except in the case of UNICEF), but company employees may be seconded temporarily to charities and the expense deducted from profit calculations for income tax purposes.<sup>123</sup>
- \* Donations made to foreign charities do not qualify the donor for tax relief.

## PROCESS FOR GRANTING CHARITABLE STATUS

To qualify for charitable status, most organizations must register with the Charity Commissioners. Those that do **not** have to register include:

- \* educational and other institutions named in the *Charities Act 1960*
- \* places of worship under the *Places of Worship Registration Act 1855*
- \* charities without a permanent endowment or land
- \* charities whose income is less than 1000 pounds a year<sup>124</sup>
- \* charities in Scotland and Northern Ireland.
- \* exempt charities (as defined in the introduction to this chapter)<sup>125</sup>

Documentation must be submitted in support of registration. Usually, this includes a trust deed, outlining the objectives of the charity, the duties of the trustees and the way in which funds are to be administered. In doubtful cases, the Charity Commissioners may consult with the UK Inland Revenue ministry before issuing a registration, which is necessary to obtain the tax reliefs outlined above. For example, if a charity uses funds for non-charitable purposes, both its tax exemption and charitable status can be withdrawn.<sup>126</sup>

Charities must prepare annual accounts and submit them to the Charity Commissioners for review. The following information is required:

- \* particulars of the assets and the persons in whom they are vested
- \* the approximate amount of liabilities
- \* the amount of receipts for the year
- \* the amount of payments made during the year<sup>127</sup>

Charities with gross income and expenditures over 100,000 pounds must also be audited annually.<sup>128</sup>

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<sup>122</sup> [Charitable Contributions in the OECD: A Tax Study](#), p. 159.

<sup>123</sup> [Charitable Contributions in the OECD: A Tax Study](#), p. 155.

<sup>124</sup> [Halsbury's Laws of England](#), para. 279, p. 190 (formerly 15 pounds annually).

<sup>125</sup> Inland Revenue, [Tax Reliefs for Charities](#). Publication IR 75: June 1987, p. 3.

<sup>126</sup> [Charitable Contributions in the OECD: A Tax Study](#), pp. 153-4.

<sup>127</sup> [Halsbury's Laws of England](#), para. 304, p. 203.

<sup>128</sup> [Halsbury's Laws of England](#), para. 307, p. 205.

## FRANCE

In France, the tradition of a centralized, interventionist state has resulted in a weaker charitable sector than in other countries, although fiscal pressures in the last decade are forcing even the French government to consider greater reliance on the non-profit sector. As Jacques Chirac pointed out, in a 1986 address to an international conference on private sector initiatives:

... two imperatives arise simultaneously, i.e.,

- helping to bring the various participants in the economy and society closer together, or at least to eliminate the obstacles to their relations ...
- reducing the number and type of interventions by the government, which should focus on its mandate of sovereignty and leave to others the tasks close at hand that respond today to the immediate needs of the greatest number. On this second point, for France the process has clearly been initiated; the State apparatus has started to lighten, in terms of both structures and manpower.<sup>129</sup>

Despite this official openness to encouragement of the “Third Sector”, the acquisition of a legal personality in France is “complicated for those organizations for which French law requires government approval”.<sup>130</sup>

The legal framework for charitable institutions in France is based on the Napoleonic Code which, unlike English Common Law, does not recognize the concept of trusteeship. Trust law deals with relations between individuals, rather than organizations, and does not confer legal personality (a measure which provides some relief from personal liability for members). In France, and in most other civil law countries, many non-profit organizations are defined in both public and private law and are granted legal personality.<sup>131</sup> Currently, legal personality is granted to:

- 1) foundations - given non-profit status through a decree by the State Council; (Until 1987, foundations in France were not fully recognized as legal personalities. Prior to that date, recognition was based on custom.)<sup>132</sup>
- 2) “recognized associations” (Établissements d’Utilité Publique) - officially recognized by the government and the courts;
- 3) “declared associations” - declared by a court of law to be charitable and registered with the regional government office, with by-laws of the association entered into an official journal.

Those *without* legal personality (which are not registered with or approved formally by the government) include:

- 1) “undeclared associations”
- 2) “de facto associations”.<sup>133</sup>

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<sup>129</sup> Opening Address, Jacques Chirac, Prime Minister of France, A Report on the International Conference on Private Sector Initiatives, Paris, France, November 24-26, 1986, p. 17.

<sup>130</sup> Charitable Donations in the OECD: A Tax Study, p. 64.

<sup>131</sup> Anita Randon and Perri 6, Liberty, Charity and Politics. London: National Council for Voluntary Organisations, December 1992, p. 4.

<sup>132</sup> Liberty, Charity and Politics, p. 17.

<sup>133</sup> Liberty, Charity and Politics, p. 17 and Derek Allen, A Comparative Study of the Tax Treatment of Donors to Charity in 35 Countries. Maidstone, Kent: Interphil, June 1987, p. 12.

In any event, the possession of legal personality is not in itself sufficient to obtain charitable status, as outlined below. Many organizations falling into the categories of “undeclared” or “de facto” associations can, in fact, qualify for charitable status under the tax laws.

## DEFINITION OF CHARITABLE STATUS

Under French tax laws, the following are recognized as charitable organizations, provided that they engage in *non-profit activities*:

- 1) associations which operate for philanthropic, educational, scientific, social assistance, humanitarian, family-related, sports, or cultural purposes, for the preservation of nature, the advancement of the French language or the creation, promotion or protection of works of art or writers' works;
- 2) entities, whether associations or foundations, which serve the public interest and are recognized as such by government authorities;
- 3) colleges and universities which have been approved by the Ministry of Higher Education and the Ministry of Finance;
- 4) schools and colleges teaching art courses, provided that they are non-profit organizations and have been approved by the Ministry of Finance and the Ministry of Culture.<sup>134</sup>

Support for the arts or sports events are clearly considered charitable purposes in France. In fact, tax laws were changed in 1987 to allow corporations to deduct as business expenses 100% of the cost of sponsoring cultural events.

Restrictions on political activity by charitable organizations are much less stringent than in most Common Law countries. If associations engage in political activity that is subsidiary to their charitable activity, they must state all their objectives. Restraints on political campaigning are limited to illegal activities. In cases of illegal behaviour (as determined by the courts), official recognition as an “association reconnu d'utilité publique” is withdrawn, along with charitable status.<sup>135</sup>

## TAX TREATMENT OF CHARITIES AND DONORS

### *Charities*

In France, a charity is not subject to corporate tax on receipts derived from charitable contributions. Other benefits of charitable status include:

- \* Dividends from shares in French corporations are tax exempt.
- \* A tax credit of 50 per cent of dividends issued by French corporations is applicable to any corporate tax assessed on the charity's other business income.
- \* Religious organizations and organizations providing housing to persons disabled by war or labour accidents are exempt from local tax rates.
- \* Government-owned colleges and universities are exempt from local dwelling taxes.
- \* Foundations and recognized associations benefit from reduced duties on the acquisition of real estate.

<sup>134</sup> [Charitable Contributions in the OECD: A Tax Study](#), pp. 60-1.

<sup>135</sup> [Liberty, Charity and Politics](#), pp. 17-18 and [Charitable Contributions in the OECD: A Tax Study](#), p. 61.

- \* Charitable organizations are exempt from gift taxes on contributions of cash or other property, provided that they meet one of the following conditions:
- the organization has a cultural or arts promotion purpose and has been approved by the Ministry of Finance
  - the organization has a scientific research purpose and has been approved by the Ministry of Finance
  - the organization has a social assistance purpose recognized by government authorities as serving the public interest
  - it operates a college or university and has been recognized by government authorities as serving the public interest
  - the donation has been made to the French Red Cross
  - the organization's purpose is to protect animals and has been recognized by government authorities as serving the public interest.

There are restrictions, however, on the income derived from profit-oriented activities. Where a charity has earned passive investment income from real estate or financial investments it may be subject to corporate tax at a reduced rate.<sup>136</sup>

### **Donors**

Both individuals and businesses in France can make tax deductible charitable contributions to qualified recipients, subject to the following limits:

#### *Individuals*

The *total* deductions made by an individual are subject to an upper ceiling of 5 per cent of taxable income. Within this total:

- contributions to a foundation or association **recognized by government** as serving the public interest (such as the Red Cross, la Fondation de France) are deductible at a rate of 40% up to a ceiling of 5 per cent of gross taxable income;
- contributions made to **other qualified charitable organizations** are deductible at a rate of 40% up to a ceiling of 1.25 per cent of gross taxable income;
- contributions made to **organizations that provide food and shelter to persons in need** are deductible at a rate of 50% for payments up to 1,040 francs. (The amount exceeding 1,040 francs is deductible at a rate of 40% up to a ceiling of 5% or 1.25% of gross taxable income, depending on the nature of the association to which the donation is given.)<sup>137</sup>

These amounts are *not* cumulative: a donor's **total** contributions to foundations or recognized associations cannot exceed 5% of gross taxable income. If they do exceed the ceiling, no further deductions are allowed for additional donations to other charitable organizations. Cash contributions must be documented by a certificate from the recipient charity.

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<sup>136</sup> The majority of the information in this section is derived from Charitable Contributions in the OECD: A Tax Study, pp. 62-5 and 69-71.

<sup>137</sup> "Vous avez fait des dons à des oeuvres ou à des organismes d'aide aux personnes en difficulté", Ministère des finances de France, February 10, 1996. Worldwide Web Site: <http://www.ensmp.fr/~scherer/adminet/min/fin/impots/dons.html>.

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### *Businesses (including sole proprietorships and corporations)*

The *total* upper limit for charitable contributions made by businesses is .3 per cent of gross taxable income. Within this total:

- contributions to a foundation or association serving the public interest are deductible up to a ceiling of .3 per cent of gross taxable income;
- contributions to other qualified charitable organizations (such as those that operate for sporting or cultural purposes) are deductible up to a ceiling of .2 per cent of gross taxable income.

As for individuals, these amounts are not cumulative. However, individuals who run sole proprietorships are allowed donate either as a business or as an individual and to deduct the higher of the amounts permitted. Charities cannot issue certificates of donation to businesses, but businesses must still produce some type of receipt for donations.<sup>138</sup>

Both cash and non-cash assets can be donated, but donation of services is not tax deductible. Although independent appraisals of non-cash assets are not required by law, they are recommended when the value of the donated asset is high. Since 1987, businesses have been able to deduct 100% of the cost of sponsoring cultural events as a business expense.

### **PROCESS FOR GRANTING CHARITABLE STATUS**

In order to issue contribution certificates to *individual donors* for income tax purposes, all charities must be recognized by the taxation authorities. To gain such recognition, organizations that must be registered with government (for example, universities) must have been in operation for at least three years and provide proof of administrative and donor stability. Other organizations that do not need approval from government to become legal personalities (for example, cultural or environmental charities) must still have approval from taxation authorities to issue certificates for charitable donations. Recognition for charitable tax purposes is not, however, automatic in either case. In cases where charitable status has been denied, it is extremely difficult for the donor to claim tax benefits, even when an organization has been approved by another government department, such as the Ministry of Culture.

Recognized associations serving the public interest and foundations must send copies of their annual statements to the Interior Ministry. All charities, even those that are not recognized associations or foundations, must also file their by-laws with the Ministry, although declared and undeclared associations are not required to provide annual statements. Charities are expected to use donations in accordance with their by-laws, but are not required by law to expend a specific percentage on charitable activities.

Annual corporate tax returns must be filed by any charity that earns income from profit-oriented activities.<sup>139</sup>

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<sup>138</sup> The majority of the information in this section is derived from Charitable Contributions in the OECD: A Tax Study, pp. 66-7.

<sup>139</sup> The majority of the information in this section is derived from Charitable Contributions in the OECD: A Tax Study, pp. 61, 63- 65, 67 and 71.

## AUSTRALIA

The non-profit sector in Australia is large, and has been estimated to operate over one-quarter of the schools, three-quarters of day care services, one third of nursing home beds, more than half of all welfare services and almost all sport and recreational pursuits in the country.<sup>140</sup> Many of these organizations work in partnership with government and receive both direct and indirect subsidies from the state. Among the latter are exemption from the payment of income tax (which most non-profits enjoy) and the right to receive tax deductible charitable donations (which is more restricted).

The legal concept of charity in Australia is derived from English Common Law, and is similar in scope insofar as exemption from income taxes is concerned. However, only certain organizations qualify as a charity entitled to receive tax deductible contributions from donors. Because of the increasing pressure on Australian governments, at both the national and state levels, to balance budgets, more attention has begun to be paid to the granting of charitable status to non-profit organizations. This, in fact, has been the subject of a recommendation by an Industry Commission inquiring into charitable organizations in Australia, which has suggested that “The Commonwealth Government should retain the tax deductibility of donations and extend it to donations made to all Community Social Welfare Organisations.”<sup>141</sup>

In its response to the Industry Commission’s 1995 Report on Charitable Organisations, the Government of Australia indicated that it “supported the broad objectives of ongoing review of the tax deductible status of non-government aid organisations but would examine further the actual approach to be adopted for implementation.”<sup>142</sup> At the time of writing of this study, no action had as yet been taken on this recommendation. The following sections describe policies as they existed in the latter part of the 1995, but this situation could change if the Australian government decides to take action on the recommendation cited above.

### DEFINITION OF CHARITABLE STATUS

Section 78(1) of the *Income Tax Assessment Act* lists all organizations entitled to receive tax deductible contributions. It is an extensive list, including (in addition to those categories outlined below) over 75 organizations specifically recognized in the *Act*. The main general categories of organizations considered charitable include:

- \* public hospitals and public funds providing money for hospitals
- \* public benevolent institutions (such as organizations for the relief of poverty, sickness, destitution and misfortune)
- \* public authorities engaged in disease research
- \* public universities and colleges and funds in their support
- \* residential educational institutions affiliated with universities and colleges
- \* funds supporting the construction or maintenance of war memorials
- \* public funds for the comfort, recreation or welfare of members of the armed forces

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<sup>140</sup> Mark Lyons, “Government and the Nonprofit Sector in Australia: An Overview”, Paper prepared for the 1990 Spring Research Forum: “The Nonprofit Sector (NGO’s) in the United States and Abroad: Cross-Cultural Perspectives”, Boston, Massachusetts, March 15-16, 1990, p. 558.

<sup>141</sup> Overview of the Draft Report, Charitable Organisations in Australia: An inquiry into Community Social Welfare Organisations. Australia: Industry Commission, October 27, 1994, p. 17.

<sup>142</sup> “Government Welcomes Report on Charitable Organisations”, Joint Media Release, Treasurer, Minister for Human Services and Health and Minister for Development Cooperation and Pacific Island Affairs, 27 September 1995, p. 2.

- \* the Commonwealth or State for defence purposes
- \* approved scientific research institutes
- \* public funds for school construction or maintenance
- \* public libraries, museums and art galleries
- \* public funds for groups providing marriage counselling
- \* public funds established under a will or public trust to support any of the categories of organizations or specific organizations listed in the *Act*.

Organizations excluded by this definition include religious institutions, political parties, political activist groups, non-Australian organizations, chambers of commerce and social and sports clubs.

In some instances, the *Income Tax Assessment Act* requires that public funds be established into which gifts of property or money must be placed if they are to qualify as allowable deductions. Generally, the *Act* stipulates how deductible donations made to a fund must be used. No detailed conditions are included in the *Act* for the use of public funds for public museums, art galleries and libraries, but there is an implied condition that donated moneys will be used only for purposes for which the particular organization was established.<sup>143</sup> In the event that an organization with charitable status ceases to exist, the tax legislation may require that its public fund be transferred to another fund or organization with the same purpose.<sup>144</sup>

Public benevolent institutions are the most favoured class of institutions in terms of tax concessions. In addition to being able to receive tax deductible donations, they are also exempt from income tax, sales tax, fringe benefits tax and many taxes imposed by state and local governments.<sup>145</sup> The definition of a Public Benevolent Institution (PBI) has been left mainly to the courts in Australia, but the Australian Taxation Office has interpreted case law to mean that a PBI is an organization which:

- \* has as its main or principal object, the relief of poverty, sickness, suffering, distress, misfortune, destitution or helplessness;
- \* is carried on without purpose or private gain for particular persons;
- \* is established for the benefit of a disadvantaged section or class of the public;
- \* makes relief available without discrimination to every member of that section of the public which the organisation aims to benefit; and
- \* gives aid directly to those in need.<sup>146</sup>

Organizations that have been held by the courts **not** to fall within the definition of a public benevolent institution include:

- \* organizations for the encouragement of mere sport (unless the sport is connected with education)
- \* organizations for “patriotic purposes”
- \* associations to present artistic and dramatic works.

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<sup>143</sup> Commissioner of Taxation, Taxation Ruling - Income Tax: public funds. Australian Taxation Office: TR 95/27, 2 August 1995, para. 26, p. 7.

<sup>144</sup> Taxation Ruling - Income Tax: public funds, para. 29, p. 8

<sup>145</sup> Personal communication from Mr. Ian Pittard, Office of the Assistant Commissioner, Tax Law Services, Australian Tax Office, October 13, 1995.

<sup>146</sup> Industry Commission, Charitable Organisations in Australia. Report No. 45. Melbourne: Australian Government Publishing Service, 16 June 1995, p. 276, quoting from tax determination TD 93/11.

On the other hand, the following have been found to fall **within** the definition:

- \* public radio stations licenced under the *Broadcasting and Television Act*
- \* organizations promoting the preservation of land and buildings or beauty or of historical interest.<sup>147</sup>

The Industry Commission investigating the charitable status of community social welfare organizations has observed that:

The benefit of tax deductibility is currently restricted to PBI (Public Benevolent Institutions) and some other listed organisations. This favours PBI over other CSWOs (Community Social Welfare Organisations). The latter are often small and provide services in more indirect ways such as advocacy or self help. This unreasonably limits the ability of this group to raise funds. The Commission considers that distinctions within the sector for tax deductibility purposes should be removed.<sup>148</sup>

Even if this restriction is removed, however, the Commission itself expresses little optimism that it will significantly increase donations to CSWOs by the public.<sup>149</sup>

## TAX TREATMENT OF CHARITIES AND DONORS<sup>150</sup>

### *Charities*

Organizations covered by the *Income Tax Assessment Act* can receive a variety of cash and non-cash donations without being subject to income tax and. In addition, donors to these organizations can claim an income tax deduction. Other benefits include the following:

- \* Business income earned by a charity is tax-exempt.
- \* Charities, as defined above, may be exempt from a variety of other federal, state and local taxes, including the Fringe Benefits Tax, sales tax, property taxes, payroll tax, taxes on financial transactions and motor vehicle registration tax.<sup>151</sup>
  - Public benevolent institutions (which includes non-profit hospitals) are fully exempt from the Fringe Benefits Tax, while religious institutions are exempt from the tax for benefits provided to their religious practitioners, but not for benefits provided to other employees.<sup>152</sup>
  - Only the following types of organizations are eligible for exemption from sales tax:
    - public hospitals
    - non-profit private hospitals
    - public benevolent institutions
    - non-profit schools and universities

<sup>147</sup> [Australian Federal Tax Reporter](#). CCH Australia Limited: 1993, Div. 1- General, Section 23(e), pp. 3,781-3,782.

<sup>148</sup> [Overview of the Draft Report, Charitable Organisations in Australia](#), p. 17.

<sup>149</sup> [Overview of the Draft Report, Charitable Organisations in Australia](#), p. 20.

<sup>150</sup> Most of the information in this section is derived from [Charitable Contributions in the OECD: A Tax Study](#), pp. 4-8.

<sup>151</sup> [Charitable Contributions in the OECD: A Tax Study](#), p. 4.

<sup>152</sup> Small Business Section, [The Club Pack: A taxation guide for clubs, societies and associations](#). Australian Tax Office: July 1994, pp. 18-19.

- child care centres
- medical research bodies
- organizations which raise funds or promote the interests of the above institutions.<sup>153</sup>

It should be noted that the Industry Commission on charities in Australia disapproved of such exemptions on the basis that they reward charities for various “inputs” rather than for the results they achieve. However, recognizing that many charities depend on these exemptions, it did not recommend their withdrawal until alternative means of support have been developed.<sup>154</sup> In the end, the government indicated that it did “not accept that the fringe benefit tax exemption for charitable organisations should be removed”.<sup>155</sup>

- \* Organizations that are **not** able to receive tax deductible donations may still qualify for **income tax exemption** if they are one of the following:
  - a religious, educational, scientific or charitable institution
  - a non-profit organization established for the encouragement of music, art, literature or science
  - a non-profit organization established for the encouragement or promotion of a game or sport
  - a non-profit organization established for community service purposes.<sup>156</sup>

The Industry Commission recommended in 1995 that the income tax free status of community social welfare organizations be retained. While the government has accepted this recommendation, it has also stated that “We do not intend to extend income tax exempt status to organisations not currently exempt.”<sup>157</sup>

A number of restrictions also apply:

- \* Charities must pay income tax on any investments transferred to them as part of a tax avoidance scheme.
- \* Bequests made to charities may be subject to capital gains tax (although any capital gains made by the charity subsequent to the bequest are tax-exempt).

In 1995, the Industry Commission on Charitable Organisations recommended that “Assets bequeathed to charitable organisations that enjoy tax deductibility should be free from any capital gains liability”.<sup>158</sup> The government has agreed to give “further consideration” to this recommendation.<sup>159</sup>

- \* Charitable trusts must distribute at least 85 per cent of their annual income if they are to retain their tax exempt status. The Industry Commission has recommended that “The Australian Tax Office should not impose restrictions on the accumulation of income by

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<sup>153</sup> The Club Pack: A taxation guide for clubs, societies and associations, p. 19.

<sup>154</sup> Overview of the Draft Report, Charitable Organisations in Australia, p. 19.

<sup>155</sup> “Government Welcomes Report on Charitable Organisations”, p. 2.

<sup>156</sup> The Club Pack: A taxation guide for clubs, societies and associations, p. 6.

<sup>157</sup> “Government Welcomes Report on Charitable Organisations”, p. 2.

<sup>158</sup> Industry Commission, Charitable Organisations in Australia. Report No. 45. Melbourne: Australian Government Publishing Service, 16 June 1995, p. 317.

<sup>159</sup> “Government Welcomes Report on Charitable Organisations”, p. 7.

charitable trusts.”<sup>160</sup> The government has agreed to give “further consideration” to this recommendation.<sup>161</sup>

### **Donors**

All Australian taxpayers, including individuals, corporations, trustees of funds, estates or partnerships (both resident and non-resident) may deduct charitable contributions to qualifying charities, subject to the following restrictions:

- \* The donation must be made before the end of the donor’s tax year and must be more than \$2 (Australian).<sup>162</sup>
- \* Any property donated to a recognized charity must have been purchased by the donor not more than 12 months before the gift is made.
- \* The amount deductible for property donations to recognized charities (except works of art) is the lesser of the donor’s purchase price or the fair market value at the time of donation.
- \* Donations of works of art to recognized charities must include written appraisals by two or more approved appraisers (done within 90 days before or after the donation). Valuations must be certified by the Committee on Taxation Incentives for the Arts Scheme. The taxpayer’s deduction is therefore based on the market value at the time of donation.
- \* No deduction can be made for the value of services donated to a recognized charity by a tax-payer, including out-of-pocket expenses.
- \* Corporate donors may be able to deduct as business expenses any gifts in support of sports or arts events, provided that such expenses are incurred for advertising or goodwill purposes. Organizations supported through business sponsorships do **not** have to be recognized charities. An official of the Australian Tax Office (ATO) has advised that, “Business deductions of this type are usually allowed, based on the presumption that supporting causes which the public sees as worthy raises the profile of the business in the estimation of the community and is therefore good for the ongoing profitability of the business.” However, the ATO does not permit a deduction for the donation of business services, such as accountancy.<sup>163</sup>

### **PROCESS FOR GRANTING CHARITABLE STATUS**

Organizations in Australia are not compelled by law to seek approval from the government for tax deductible charitable status.<sup>164</sup> However, in practice, they are encouraged to submit an application to the Australian Taxation Office (ATO), since donors may be left with tax liabilities if an organization receives donations that are later declared not to be tax deductible by the tax authorities. The ATO examines the following information to determine whether a fund or organization is qualified to receive tax deductible donations:

<sup>160</sup> Charitable Organisations in Australia, p. 251.

<sup>161</sup> Government Welcomes Report on Charitable Organisations”, p. 8.

<sup>162</sup> The Industry Commission has recommended removal of the \$2 lower limit (Charitable Organisations in Australia, p. 289).

<sup>163</sup> Personal communication from Ian Pittard, Office of the Assistant Commissioner, Tax Law Services, Australian Tax Office, 13 October 1995.

<sup>164</sup> Personal communication from Ian Pittard, 13 October 1995.

- \* the governing document outlining the objects of the organization, whether it operates on a non-profit basis and what provisions exist for disposal of assets on winding up
- \* annual reports and other publications describing the organization's activities
- \* financial statements, particularly income and expenditure statements
- \* any legislation governing the organization, particularly if it requires that a public fund be established.<sup>165</sup>

Once charitable status is approved, there appears to be limited oversight of the organization, since charities are usually not required to file annual income tax returns. If an organization changes its charitable purpose, it may need to re-apply for charitable status, but this appears to be left to the discretion of the organization.

The Industry Commission examining charitable organizations in Australia commented somewhat negatively about the lack of monitoring and oversight of approved charities:

The Commission was informed that many CSWOs (Community Social Welfare Organisations) were granted PBI (Public Benevolent Institution) status decades ago, and that it is doubtful whether some of them would now be granted that status by tests which currently apply to new applicants.<sup>166</sup>

It went on to recommend that, "The Australian Tax Office should introduce a process of review of Community Social Welfare Organisations receiving tax deductibility status and other tax benefits".<sup>167</sup> The stated reasons for this recommendation were to improve the accountability of charities for the tax dollars and donations they receive and to streamline overlapping reporting requirements of various governments. In its response, the government has stated that it supports the "broad objectives of ongoing review of the tax deductible status of non-government aid organisations but would examine further the actual approach to be adopted for implementation".<sup>168</sup>

## NEW ZEALAND

Charitable purposes in New Zealand are based upon English Common Law precedents, as outlined in the section of this report dealing with the United Kingdom. As in the United Kingdom, "charitable purposes must be for the public benefit" and must be based on "a positive moral virtue".<sup>169</sup> Beyond these general strictures, New Zealand has a very explicit definition of charitable status that covers a wide range of activities.

### DEFINITION OF CHARITABLE STATUS

In New Zealand, the Inland Revenue Department examines applications by organizations for either **approved charity status or donee organization status**.

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<sup>165</sup> Personal communication from Ian Pittard, 13 October 1995.

<sup>166</sup> [Overview of the Draft Report, Charitable Organisations in Australia](#), p. 28.

<sup>167</sup> [Charitable Organisations in Australia](#), p. 309.

<sup>168</sup> "Government Welcomes Report on Charitable Organisations", p. 2.

<sup>169</sup> P.J. Downey, "Charity and the law", [The New Zealand Law Journal](#), 21 December 1989, pp. 405 and 406.

An **approved charity** in New Zealand must carry on charitable activities in one or more of the following areas:

- 1) Relief of poverty, which includes:
  - \* care of the aged, children and orphans
  - \* care of the infirm, crippled, blind war veterans and disabled persons
  - \* care of the intellectually handicapped, discharged prisoners and alcoholics
  - \* helping other needy persons
- 2) Advancement of education, which includes:
  - \* the advancement and passing on of education and learning (e.g. universities, art galleries, libraries and museums, activities such as producing or improving sporting facilities for schools or universities or developing the character of young people)
  - \* research leading to an increase in the store of knowledge or improving learning in a field of education (e.g. medical research centres)
  - \* acquiring knowledge, if the intention is that learning be passed on (e.g. publishing and selling law reports)
- 3) Advancement of religion, including:
  - \* promoting religion by spreading its message
  - \* providing and maintaining grounds and buildings for use by religious organizations
- 4) Other purposes beneficial to the community, including:
  - \* providing ambulance, fire brigade or life-saving services
  - \* providing **public** halls, recreational facilities, botanical gardens and parks (but any facilities created purely for the promotion of sport or social activities would not qualify)
    - \* afforestation or the creation of national parks or domains
    - \* repairing highways and bridges, providing water supplies, paving and lighting a town
    - \* social rehabilitation

An **approved donee organization** qualifies for more limited tax advantages than an approved charity. A qualified donee organization must:

- \* be a New Zealand society, institution, association, organization, trust or fund
- \* use most of its funds for purposes within New Zealand
- \* have a charitable purpose (as defined above) OR
- \* have a cultural purpose (defined as dramatic, theatrical, operatic, ballet, choral or musical activities) OR
- \* have a benevolent or philanthropic purpose not falling within the above definition of “charitable” purposes.

An organization can be **both** an approved charity and a donee organization, which qualifies it for the full range of benefits outlined in the following section.<sup>170</sup>

Activities that would disqualify an organization from obtaining approved charitable status include political activity aimed at seeking changes to existing laws, use of funds to provide personal benefits to members, trustees or associates of the organization and use of business income for charitable purposes outside of New Zealand.<sup>171</sup>

<sup>170</sup> Inland Revenue, Charitable Organisations - A tax guide for charities, donee organisations and other groups, Publication Number IR 255, May 1993, pp. 28-32.

<sup>171</sup> Charitable Organisations - A tax guide for charities, donee organisations and other groups, pp. 36-41.

## TAX TREATMENT OF CHARITIES AND DONORS

As indicated above, charitable organizations and donee organizations qualify for somewhat different tax treatment under New Zealand tax laws.

### **Approved Charity**

An approved charity is eligible for the following tax benefits in New Zealand:

- 1) Under Section 61(5) of the *Income Tax Act 1976*, an approved charity is exempt from income tax on income from interest, dividends and rents.
- 2) Under Section 61(27) of the *Income Tax Act 1976*, an approved charity is exempt from income tax on business income from approved trading activities, as long as this income is used for charitable purposes within New Zealand.
- 3) Under Section 61(26) of the *Income Tax Act 1976*, an approved charity is exempt from income tax on income earned by an estate awaiting administration, as long as the charity is a beneficiary.
- 4) Under Section 73(1) of the *Estate and Gift Duties Act 1968*, any gift made to create a charitable trust, establish a charitable society or aid an approved charity is exempt from gift duty.
- 5) Under Section 18 of the *Stamp and Cheque Duties Act 1971*, no conveyance duty is paid on any transfer of property used to create a charitable trust, establish a charitable society or held in charitable trust by an approved charity. This exemption also applies when an approved charity purchases property.<sup>172</sup>
- 6) Certain types of charitable income are exempt from the Goods and Services Tax (which is similar to the Canadian GST). Exempt income includes income from financial services (such as bank interest and dividends from public companies), proceeds from selling donated goods and services and rent received from residential accommodations. In addition, donations and bequests are not liable for the GST.<sup>173</sup>
- 7) Approved charities can also apply for a Certificate of Exemption from the Resident Withholding Tax, which is deducted from interest and dividend income before the organization receives it.<sup>174</sup>
- 8) Approved charities or donee organizations are exempt from Fringe Benefit Tax on any benefits provided to employees while they are carrying out charitable activities (for example, use of a car during working hours).<sup>175</sup>
- 9) Certain approved charities that are also voluntary welfare organizations can also obtain reductions in telephone rates from the state telecommunications provider.<sup>176</sup>

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<sup>172</sup> Charitable Organisations - A tax guide for charities, donee organisations and other groups, pp. 33-35.

<sup>173</sup> Charitable Organisations, p. 44.

<sup>174</sup> Charitable Organisations, pp. 21-22.

<sup>175</sup> Charitable Organisations, p. 19.

<sup>176</sup> Charitable Organisations, p. 46.

However, if a charity has no written constitution or trust deed, ceases to meet the requirements for tax exemption or uses business income outside of New Zealand, it must pay income tax at the company rate (currently 33 cents on the dollar) and loses the benefits outlined above.<sup>177</sup>

### ***Donee Organization***

A donee organization is eligible to receive tax exempt donations from individuals and businesses under the *Income Tax Act 1976* (see below), but does not qualify for any of the other tax advantages outlined above. In practice, many organizations are both approved charities and donee organizations, which entitles them to the full range of tax benefits.

### ***Donors***

#### *Individuals*

Under Section 56A of the *Income Tax Act 1976*, individuals can claim a tax rebate of 33 1/3 per cent or \$500 (whichever is less) on all cash donations of \$5 or more to approved charities or donee organizations. However, the gift must be made in money -- gifts of goods, articles or property do not qualify.<sup>178</sup>

#### *Public Companies*

Under Section 147 of the *Income Tax Act 1976*, public companies can claim deductions against income of cash donations to approved donee organizations.

If the donation is made to a **single** donee organization, the maximum deduction is the greater of 1 per cent of the company's income or \$4,000.

If the donation is made to **multiple** organizations, the maximum deduction is the greater of \$1,000 or 5 per cent of the company's income.<sup>179</sup>

Businesses may also deduct from income tax payments any expenses incurred in sponsoring artistic or sports events, provided that the sponsorship meets the following

- There is a written contract specifying that the payment is for advertising.
- Payments are \$100 or more per annum.
- The advertising gives full value for payment in one or more of the following media: newspapers, brochures, television, radio, magazines.
- When the advertising is solely through brochures, there is reasonable distribution of those brochures.<sup>180</sup>

## **PROCESS FOR GRANTING CHARITABLE STATUS**

An organization applying for approved charitable status or approved donee organization status must send the Inland Revenue Department:

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<sup>177</sup> Charitable Organisations, p. 10.

<sup>178</sup> Charitable Organisations, p. 33.

<sup>179</sup> Charitable Organisations, p. 34.

<sup>180</sup> Letter from Rob Falk, Senior Technical Officer, Rulings, Inland Revenue Department, Wellington, New Zealand, August 11, 1995.

- \* an up-to-date copy of its rules, constitution, trust deed or other founding documents
- \* a copy of its certificate of incorporation (if incorporated)
- \* a letter stating the type of exemptions requested
- \* details of its operations.

To become incorporated, an organization must have registered with the Commercial Affairs Division of the Department of Justice. Incorporation for a charity may fall under a number of acts, including the *Charitable Trusts Act 1957*, the *Incorporated Societies Act 1908* or the *Companies Act 1955*. However, registration under the *Charitable Trusts Act* does not automatically qualify the organization for charitable status, and the approval process with Inland Revenue must still be followed.

Inland Revenue assesses applications according to the following criteria:

- \* whether an organization's activities are exclusively charitable
- \* whether an organization's funds are being used to provide personal benefits for members, trustees or associates
- \* whether an organization can change its rules, constitution or trust deed (clauses dealing with charitable purposes, benefits to members and winding up of the organization cannot be changed)
- \* whether the donee organization operates exclusively in New Zealand
- \* whether on "winding down" the organization's assets are transferred to another approved charity or donee organization operating in New Zealand
- \* whether business income is being used within New Zealand for charitable purposes.

Approval is conveyed in writing, stating the tax exemptions for which the organization qualifies. If Inland Revenue is not satisfied with the organization's rules, it sends a letter explaining the amendments required before exemption will be granted. If an organization disagrees with Inland Revenue's decision, it can file a formal objection.<sup>181</sup>

If Inland Revenue grants an organization full exemption from income tax, the organization does not normally have to file annual income tax returns. However, if an approved charity runs a business or receives business income, it must file. In addition, all approved charities and donee organizations with taxable activity of \$30,000 or more must register for the GST and file a GST return every two months. As an employer, an approved charity or a donee organization must also register with Inland Revenue as an employer and pay all applicable payroll taxes.<sup>182</sup>

## MEXICO

The legal rules governing charities in Mexico are derived, as in France, from civil law. Therefore, development of the charitable sector has, historically, been subject to many of the same restrictions as in France, reflecting, as one commentator has noted, "the long-standing conflict between the state and the church and, more broadly, the state's traditional mistrust of private initiatives to address public concerns".<sup>183</sup> Recent political and economic developments in Mexico have prompted the Mexican government to make a number of changes to the tax system to encourage greater philanthropic activity, but there appears to be some confusion among Mexican charities about the new rules. (For example, at a recent conference with

<sup>181</sup> Charitable Organisations, p. 26 and pp. 35-43.

<sup>182</sup> Charitable Organisations, pp. 11-16.

<sup>183</sup> Milton Czerny, "International Philanthropy - Cross-Border Grant Making and the US-Mexico Tax Treaty", Tax Notes International, October 10, 1994, p. 1145.

American tax authorities, Mexican charities appeared to believe -- erroneously -- that a \$5,000 ceiling was being placed on the amount of any contribution by American citizens to Mexican charities.)<sup>184</sup>

In recognition of the fact that the system for regulating charities (as described below) is still far more restrictive than those of its major trading partners, particularly its NAFTA trading partners, Mexican authorities are studying the following issues:

- \* the need for clearer definition of the types of organizations that can qualify as charities
- \* the need to determine the extent to which Mexico should adopt regulatory approaches employed by other countries
- \* the need to establish procedural rules that appropriately limit government discretion in regulating charities.<sup>185</sup>

## DEFINITION OF CHARITABLE STATUS

Charities in Mexico must be established either as **private charitable institutions**, which operate under the auspices of government-constituted boards, or **civil associations**, authorized to receive donations under the Mexican *Income Tax Law*.

**Private charitable institutions** are defined under Article 1 of the *Law on Private Charitable Institutions by the Federal District* as:

... legal entities which, using their own privately owned assets, perform actions for humanitarian purposes on a not-for-profit basis and without designating beneficiaries individually.<sup>186</sup>

In addition, the Law applies to “institutions of which the purpose is to perform works of solidarity aimed at social development”.<sup>187</sup>

Private charitable institutions are supervised by the Private Charities Board, a decentralized administrative body falling within the Department of the Federal District. The Board is responsible for approving the establishment of private charitable institutions and for providing oversight of and advice on their operations.<sup>188</sup>

Various restrictions apply to the activities of private charitable institutions. For example, they cannot acquire more real estate than is required to carry out their charitable purposes, and charities established to aid foreigners must still provide 25 per cent of their assistance to Mexican clients.<sup>189</sup>

Tax exempt **civil associations**, as defined in Article 70 (VI) of the Mexican *Income Tax Law*, are:

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<sup>184</sup> Milton Czerny, p. 1145.

<sup>185</sup> Milton Czerny, p. 1145.

<sup>186</sup> Translation of Article 1 of the *Law on Private Charitable Institutions by the Federal District*, provided by the Mexican Embassy from Chamber of Deputies Library Committee, Integrated Information and Documentation System, CD-ROM 2, Federal Legislation.

<sup>187</sup> Article 1, *Law on Private Charitable Institutions by the Federal District* (translation).

<sup>188</sup> Article 83, *Law on Private Charitable Institutions by the Federal District*.

<sup>189</sup> Articles 73 and 79, *Law on Private Charitable Institutions by the Federal District*.

Service or charitable organizations authorized by the applicable laws, as well as civil societies or associations authorized to receive donations under the terms of this *Law* which, without designating the beneficiaries individually, are engaged in the activities indicated below:

- a) Services to persons who, because of their socio-economic situation or problems of disability, are unable to provide for their basic subsistence and development needs;
- b) Services in establishments specialized in minors and the elderly who are abandoned or lack protection or in low-income disabled persons;
- c) Supplying medical or legal services, guidance or funeral services to low-income persons, especially minors, the elderly and the disabled;
- d) Rehabilitation of persons who have been in trouble with the law; or
- e) Rehabilitation of drug addicts with few resources.<sup>190</sup>

Also tax-exempt under Article 70 are civil associations involved in teaching whose curricula are recognized under the *General Education Law*, civil associations organized for cultural, scientific or technological research purposes, libraries and museums, societies of authors established in compliance with the *Federal Copyright Law*, civil associations organized for political, athletic or religious purposes and civil associations which award scholarships.

## TAX TREATMENT OF CHARITIES AND DONORS

### *Charities*

To be considered as organizations authorized to receive tax-deductible charitable donations under the Mexican *Income Tax Law*, **civil associations** engaged in charitable work, as defined above, or organized for teaching, cultural, scientific or technological purposes (including libraries and museums) must either obtain a substantial part of their revenue from the state or from donations. They are not allowed to receive excessive amounts of income from rental fees, interest, dividends or royalties. Other restrictions include a prohibition on political activity and on the distribution of any benefit to members of the association.<sup>191</sup>

Foundations that provide financial support to civil associations that are authorized to receive tax-deductible charitable donations may also themselves receive such donations, provided that they assign all of their revenue to charitable purposes.<sup>192</sup>

**Private charitable institutions** deemed to be in the public interest by the Private Charities Board are exempt from the payment of federal taxes, fees and royalties, including taxes on any products manufactured in their own workshops and sold directly by the institutions. The receipt of tax-deductible donations by private charitable institutions is, however, complicated by a number of conditions imposed by the Private Charities Board:

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<sup>190</sup> Translation of Article 70 (VI), *Income Tax Law*, provided by the Mexican Embassy from the Chamber of Deputies Library Committee, Integrated Information and Documentation System, CD-ROM 2, Federal Legislation.

<sup>191</sup> Article 70-B, *Income Tax Law* (translation).

<sup>192</sup> Article 70-A, *Income Tax Law* (translation).

- \* Donations received by private charitable institutions require the prior authorization of the Private Charities Board when they are substantial or conditional. Any person wishing to make a large or conditional donation to an institution must indicate this in writing to the institution's trustees, who are then obliged to inform the Board. Once authorization is received, the institution must inform the donor in writing of the decision.
- \* Donations can be revoked or reduced by courts if they interfere with the donor's obligation to provide support to persons whom he or she is required by law to support.
- \* To collect cash donations, private charitable institutions must obtain a document, signed and sealed by the Private Charities Board, indicating the day or days on which donations are to be collected. Collection boxes must be secured in the offices of the Board and opened in the presence of the Board's inspector and the institution's trustees. The inspector then prepares a report to the Board, which is used to verify the funds collected and to determine whether they were used for the purpose indicated in the original authorization.
- \* The Private Charities Board sets individual requirements for each request to collect non-cash donations.<sup>193</sup>

### **Donors**

Donors, either individual or corporate, who donate assets to private charitable institutions may deduct the total amount of the donation from their incomes, provided that they have received a receipt issued by the recipient institution.<sup>194</sup>

Donations to qualifying charities are, in the case of companies, deductible from profit before tax assessment.<sup>195</sup>

### **PROCESS FOR GRANTING CHARITABLE STATUS**

Establishment of a private charitable institution is a fairly complicated process in Mexico. The following information must be submitted to the Private Charities Board:

- \* the name, address and other information on the founder(s)
- \* the name, purpose and address of the institution to be established
- \* the type of charitable works to be carried out
- \* the capital used to create and maintain the institution
- \* designation of the persons who will act as trustees
- \* whether the institution is permanent or temporary
- \* the general bases of administration.

When the Private Charities Board makes a favourable decision on an application, the founders must prepare by-laws within 30 days. The Board examines the by-laws, makes comments to the founders, if any corrections are required, and then approves them. Approved by-laws must be notarized by a notary public and registered with the Public Register of Property. In the case of foundations, the Board makes a ruling that all assets must be used for charitable purposes, and this decision must also be entered in the Public Property Register.<sup>196</sup>

<sup>193</sup> Articles 40, 41, 43 and 81 of the *Law on Private Charitable Institutions by the Federal District* (translation).

<sup>194</sup> Article 42, *Law on Private Charitable Institutions by the Federal District* (translation).

<sup>195</sup> Derek Allen, *A Comparative Study of the Tax Treatment of Donors to Charity in 35 Countries*, p. 25.

<sup>196</sup> Articles 13, 14, 15, 16 and 17 of *Law on Private Charitable Institutions by the Federal District* (translation).

Private charitable institutions must submit annual capital and operations budgets to the Private Charities Board, as well as their proposed work plan for the coming year. The trustees must also maintain adequate accounts, as determined by the Private Charities Board, for all operations conducted in the past year.<sup>197</sup>

## JAPAN

The Japanese approach to charitable giving is both pragmatic and rooted in the Buddhist traditions of the society. According to one authority, charitable donations “are given on the basis of specific human relationships. ... Activities carried out for an anonymous ‘public’ where no defined relationships exist are extremely difficult to maintain”.<sup>198</sup> Strong central government is another factor that has been frequently cited to explain patterns of Japanese philanthropy. Many activities that are considered “charitable” in western society have simply been carried out by government using tax dollars.<sup>199</sup> In general, these influences are said to have limited the role of private giving in Japan. One source estimated in 1989 that per capita donations in Japan amounted to about \$25 annually, as compared with about \$370 per capita in the United States.<sup>200</sup>

Over the past decade, however, Japanese corporations have increased their charitable donations, partially for pragmatic reasons related to the need to be seen as “good corporate citizens”. Despite the unfriendly tax laws, by 1988 there were 171 grant making foundations in Japan, 20 of which had assets in excess of 3 billion yen (\$22A million).<sup>201</sup> Until fairly recently, the most favourable tax status was generally accorded to scientific and high technology organizations whose activities further the competitiveness of Japanese industry. These factors, coupled with the limited tradition of private giving to “good causes”, have created a pattern of charitable donations heavily skewed toward the corporate sector.

## DEFINITION OF CHARITABLE STATUS

The following types of Japanese non-profit organizations can qualify as recipients of tax-free charitable contributions:

- \* organizations conducting activities for the public good
- \* corporations engaged in experimental and research activities
- \* corporations whose purpose is to establish an educational institution
- \* social welfare corporations
- \* political parties
- \* members of the Japanese Diet (parliament)
- \* candidates in public office who receive specific contributions.

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<sup>197</sup> Article 57, *Law on Private Charitable Institutions by the Federal District* (translation).

<sup>198</sup> M. Tanaka, “Foundations in Japan -- Their Legal Provisions and Tax Regulations” in The International Symposium on the Role of Philanthropy 7 (Japan Centre for International Exchange: Jan. 1975), p. 2, quoted by Susan L. Q. Flaherty in “Charity in the United States and Japan: Comparative Views of the Voluntary Sector and Corporate Citizenship”, a paper presented to the 1990 Spring Research Forum: *The Nonprofit Sector (NGOs) in the United States and Abroad: Cross-Cultural Perspectives*, Boston, Massachusetts, March 15-16. 1990.

<sup>199</sup> For example, Roger M. Williams in “Land of the Good Corporate Citizen”, Foundation News (November-December 19?), at p. 26, states that “Government did, and still does, most all things for most people, and it taxes them accordingly”.

<sup>200</sup> Address by Delwin A. Roy, President and Chief Executive Officer, The Hitachi Foundation, to the National Society of Fund Raising Executives, April 12, 1989.

<sup>201</sup> “Land of the Good Corporate Citizen”, p. 24.

In 1988, tax exempt status was extended to organizations operating in the field of “international exchange”.<sup>202</sup> However, foreign-based charities cannot qualify for tax-exempt status under Japanese law.<sup>203</sup>

## TAX TREATMENT OF CHARITIES AND DONORS<sup>204</sup>

### *Charities*

Charities that are eligible to receive donations are exempt from income tax, as long as they use the donated funds for the purposes designated in their charters. No tax is imposed on investment income related to the charity’s *non-profit* activities, and up to 30% of a charity’s income can be derived from profit-oriented activities. Charitable organizations that engage in profit-oriented activities beyond this limit are taxed at a corporate tax rate of 27%, instead of the ordinary corporate tax rate of 42%. Some organizations, such as social welfare corporations and qualified private educational institutions can deduct the greater of 50% of their profit-derived income or 2 million yen from taxable income when this income is transferred to the non-profit part of the organization or to another charitable organization.

Charitable organizations may also be exempt from prefectural or municipal taxes, such as stamp taxes, but this is not applicable across the board to all charities.

### *Donors*

Both individuals and corporations that are Japanese taxpayers (including foreign nationals and corporations) may receive tax benefits from donations to qualified, tax-exempt charities. Both money and property may be donated, but assets other than money must be assigned their fair market value. If fair market value cannot be determined, an expert appraisal must be made of these assets at the time of donation and verified later by audit.

#### *Individuals*

Charitable donations exceeding 10,000 yen annually to a qualified organization (as defined above) are income tax deductible, up to a limit of 25% of total gross income. Although no deduction is allowed for the value of services that a taxpayer may render to a charitable organization, out-of-pocket expenses are deductible.

#### *Corporations*

Contributions to a qualified organization (as defined above) are **fully deductible**.

Contributions to an organization to non-profit cultural, social, educational or technological development organizations that are *not* qualified (i.e. designated by the Minister of Finance) are still deductible up to 1.25% of pre-tax profits, plus .25% of capital. In addition, contributions to political and religious organizations or in support of sports events or the arts are also deductible up to 1.25% of pre-tax profits, plus .25% of capital.<sup>205</sup> In other words, up to half a corporation’s total charitable donations can be to a political party -- and, in actual practice, most corporations

<sup>202</sup> Williams, p. 26.

<sup>203</sup> Charitable Contributions in the OECD: A Tax Study, p. 86.

<sup>204</sup> Most of the information in this section is derived from Charitable Contributions in the OECD: A Tax Study, pp. 83-89.

<sup>205</sup> Charitable Contributions in the OECD: A Tax Study, p. 89.

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do use the second 1.25% of their allowable deductions for political purposes.<sup>206</sup>

## PROCESS FOR GRANTING CHARITABLE STATUS

While tax treatment of donors is relatively generous, the process for becoming a qualified tax-exempt charitable organization in Japan is neither straightforward nor easy.

Japanese non-profit organizations must first seek corporate status from the appropriate ministry. Any non-profit organization that wishes to operate in two or more prefectures must obtain this approval from the national government. Once appropriate ministry certification is obtained, the corporation must then apply to the Ministry of Finance for tax exempt charitable status.<sup>207</sup> According to one source, approval of tax exempt status is by no means a foregone conclusion, and it is estimated that half the applications are rejected.<sup>208</sup> The tax laws also discourage the creation of multi-purpose charitable foundations, providing tax exempt status only for single-purposes and requiring start-up funding of 300 to 400 million yen before corporate status will be approved..<sup>209</sup>

Certified non-profit corporations are subject to annual review by the ministry that originally approved them.<sup>210</sup> All non-profit corporations with profit-making arms, including those with tax exempt status, are required to file an annual corporate income tax return.<sup>211</sup>

Because of these stringent requirements, very few charitable organizations obtain either corporate certification or tax exempt status.

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<sup>206</sup> Williams, p.26.

<sup>207</sup> Termasa Akio, "Much Needed Corporate Status and Tax Exemption - Bottleneck for Japanese NGOs in International Exchange and Development", Worldwide Web site: <http://www.smn.co.jp/opinions/0032001e.html>.

<sup>208</sup> Williams, p. 27.

<sup>209</sup> Williams, p. 26.

<sup>210</sup> Williams, p. 27.

<sup>211</sup> Charitable Contributions in the OECD: A Tax Study, p. 84.

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APPENDIX 1

<b><i>Tax Treatment of Charities and Donors International Comparison</i></b>			
<b><u>Canada</u></b>	<b><u>Charities</u></b>	<b><u>Donors</u></b>	<b><u>Ceilings</u></b>
	<p>Exempt from income tax on:</p> <ul style="list-style-type: none"> <li>- donations</li> <li>- non-business income</li> <li>- income from “related business”</li> </ul> <p>50% rebate on the Goods and Services Tax (GST)</p> <p>Exempt from GST for:</p> <ul style="list-style-type: none"> <li>- goods and services produced by volunteers</li> <li>- goods sold at less than cost</li> <li>- food and short-term shelter provided to relieve poverty</li> <li>- charity casinos, bingos or lotteries</li> <li>- amateur performances for charity</li> <li>- classes for children 14 years or younger</li> <li>- recreational programs for the under-privileged and disabled</li> <li>- membership services</li> </ul>	<p><u>Gifts of cash and property</u></p> <p>Individuals:</p> <ul style="list-style-type: none"> <li>- tax credit of 17% on first \$200 donated</li> <li>- tax credit of 29% on amount over \$200</li> </ul> <p>Corporations: deduction from taxable income = total of amount donated</p> <p><u>Gifts to Canada and Provinces</u></p> <p>Individuals: tax credit on full amount donated</p> <p>Corporations: deduction = fair market value (FMV)</p> <p><u>Gifts of cultural property</u></p> <p>Individuals - tax credit on FMV</p> <p>Corporations - deduction = FMV</p> <p>Artists - tax credit up to FMV</p> <p><u>Gifts of ecologically-sensitive land</u></p> <p>Individuals - tax credit on full amount donated</p> <p>Corporations - deduction = FMV</p> <p><u>Gifts of capital property</u></p> <p>Individuals - tax credit on amount chosen by donor between FMV and adjusted cost base (ACB)</p> <p>Corporations - deduction = amount chosen by donor between FMV and ACB</p>	<p>Currently 20% of net income, but will rise to 50%. A 100% ceiling for bequests to charities will apply.</p> <p>No income ceiling.</p> <p>No income ceiling and no capital gains tax.</p> <p>No income ceiling. Capital gains tax may apply.</p> <p>Currently 20% of net income but will rise to 50% , plus 50% of taxable capital gain from donation.</p>

**Tax Treatment of Charities and Donors  
International Comparison**

<u><b>United States</b></u>	<u><b>Charities</b></u>	<u><b>Donors</b></u>	<u><b>Ceilings</b></u>
	<p>Exempt from U.S. income tax for most types of income, except for:</p> <ul style="list-style-type: none"> <li>- unrelated business income</li> <li>- any undistributed income of a private, non-operating foundation.</li> </ul> <p>Excise tax imposed on net investment income of certain private foundations.</p> <p>Partial tax exemption from state and local income, property and sales tax.</p> <p>Eligibility for corporate matching programs.</p>	<p><u>Gifts of cash and property</u></p> <p>Individuals: Deduction = total value of donation. Donations exempt from U.S. gift tax. Donations can be used as deduction from U.S. estate tax.</p> <p>Corporations: Deduction = total value of donation. Donations exempt from U.S. gift tax.</p> <p><u>Gifts of capital gain property</u> Individuals and corporations: Deduction = fair market value of property over \$5,000 (except in certain situations such as when property is donated to private, non-operating foundation). No capital gains tax applies.</p> <p><u>Gifts of services</u> No deduction permitted, but out-of-pocket expenses are deductible.</p>	<p><u>Individuals</u></p> <ul style="list-style-type: none"> <li>- Charities and private operating foundations - 50% of adjusted gross income</li> <li>- Private non-operating foundations - 30%</li> </ul> <p><u>Corporations</u></p> <ul style="list-style-type: none"> <li>- Up to 10% of net income</li> </ul> <p><u>Capital property</u></p> <p><u>Individuals</u></p> <ul style="list-style-type: none"> <li>- Charities and private operating foundations - 30%</li> <li>- Private non-operating foundations - 20%</li> </ul> <p><u>Capital property</u></p> <p><u>Corporations</u></p> <ul style="list-style-type: none"> <li>Up to 10% of net income</li> </ul>

**Tax Treatment of Charities and Donors  
International Comparison**

<b><u>United Kingdom</u></b>	<b><u>Charities</u></b>	<b><u>Donors</u></b>	<b><u>Ceilings</u></b>
	<p>Income tax exempt on all:</p> <ul style="list-style-type: none"> <li>- donations, interest and dividend income</li> <li>- profits from fundraising and related trade (business)</li> <li>- capital gains</li> </ul> <p>Exempt from Value Added Tax (VAT) for:</p> <ul style="list-style-type: none"> <li>- donations, grants, interest, dividends</li> <li>-voluntary services</li> <li>- rent for charity-owned facilities</li> <li>- advertising in charity brochures</li> <li>- welfare services</li> <li>- sponsorships not involving advertising</li> <li>- memberships</li> <li>- “one-off” fundraising events</li> </ul> <p>VAT zero-rating for a number of charity expenses, such as charity advertising in media, sales of donated goods, construction supplies for charity buildings.</p> <p>50% to 100% relief from property taxes.</p> <p>Exemption from inheritance and gift taxes.</p>	<p><u>Gifts of cash</u></p> <p>Individuals:</p> <p>Income tax deduction of 29% for:</p> <ol style="list-style-type: none"> <li>1) deed of covenant - 3-year charity funding agreement</li> <li>2) payroll deduction</li> <li>3) Gift Aid scheme</li> </ol> <p>Corporations:</p> <ol style="list-style-type: none"> <li>1) Deed of covenant - 25% corporate tax deduction from company profits</li> <li>2) Sponsorships - 25% corporate tax deduction from company profits</li> <li>3) Gift Aid scheme - deduction of full amount of gift from profits (but 25% tax must be paid to Inland Revenue - later reclaimed by charity)</li> </ol> <p><u>Non-cash gifts</u></p> <p>Individuals:</p> <p>Can be made through deed of covenant - no capital gains tax applies.</p> <p>Corporations:</p> <p>No deduction permitted for gifts of assets or property.</p> <p>Business expense deduction for salaries of company employees seconded to charity. charities.</p>	<p>1) No annual limits</p> <p>2) Maximum of 120 pounds p/a</p> <p>3) Minimum gift - 250 pounds</p> <p>1) 3% of dividends annually</p> <p>2) No annual limits</p> <p>3) Minimum qualifying gift - 250 pounds</p> <p>No annual limits.</p>

**Tax Treatment of Charities and Donors  
International Comparison**

<u>France</u>	<u>Charities</u>	<u>Donors</u>	<u>Ceilings</u>
	<p>Tax exemption for: - donations - dividend income from French corporations</p> <p>Tax credit = 50% of dividends from French corporations on charity's business income</p> <p>Exemption from local property taxes for some charities</p> <p>Reduced duties on real estate acquisitions for some charities</p> <p>Exemption from gift tax for some charities</p> <p>Taxation on profit-oriented income at reduced corporate rate</p>	<p><u>Individuals</u> Income tax deductions for cash and non-cash donations to:</p> <p>1) charities recognized by government - 40% 2) charities not recognized by government - 40% 3) charities providing food and shelter to persons in need:     50% - amounts up to 1,040 francs     40% - amounts over 1,040 francs</p> <p><u>Corporations</u> Income tax deductions for cash and non-cash donations to:</p> <p>1) foundations and associations recognized by government 2) other qualified charitable organizations.</p> <p>Deduction as a business expense of 100% of the cost of sponsoring a cultural event.</p>	<p><u>Total</u> donations subject to upper ceiling of 5% of taxable income.</p> <p>1) 5% of gross taxable income 2) 1.25% of gross taxable income 3) Up to ceiling of 5% or 1.25% of taxable income, depending on type of charity.</p> <p><u>Total</u> deductions subject to upper ceiling of .3% of gross taxable income. 1) .3% of gross taxable income. 2) .2% of gross taxable income.</p>

***Tax Treatment of Charities and Donors  
International Comparison***

<b><u>Australia</u></b>	<b><u>Charities</u></b>	<b><u>Donors</u></b>	<b><u>Ceilings</u></b>
	<p>Income tax exemption for:</p> <ul style="list-style-type: none"> <li>- donations</li> <li>- business income</li> </ul> <p>Exemption from Fringe Benefits Tax for public benevolent institutions and religious practitioners.</p> <p>Exemption from sales tax for some charities.</p> <p>No exemption from Capital Gains Tax on bequest to charities.</p>	<p><u>Individuals and Corporations</u></p> <p>Income tax deduction for cash donations to qualified charities.</p> <p>Income tax deduction for property donations (except works of art) at the lesser of the donor's purchase price or the fair market value (FMV).</p> <p>Income tax deduction for works of art donated to a recognized charity = FMV (two certified appraisals required).</p> <p>Deduction as business expenses by corporations of gifts in support of sports or arts events.</p> <p>No deductions permitted for donation of services.</p>	<p>No ceiling, but donations must be more than \$2 (Australian).</p>

**Tax Treatment of Charities and Donors  
International Comparison**

<u><b>New Zealand</b></u>	<u><b>Charities</b></u>	<u><b>Donors</b></u>	<u><b>Ceilings</b></u>
	<p><u>Approved Charity</u> Income tax exemption for income from:</p> <ul style="list-style-type: none"> <li>- donations</li> <li>- interest, dividends and rent</li> <li>- business (approved trading only)</li> <li>- a donated estate awaiting administration (if charity is beneficiary)</li> </ul> <p>Exemption from gift duty and conveyance duty on transfer of property.</p> <p>Exemption from the Goods and Services Tax (GST) of income from donations, financial investments, sale of donated goods, rent from residential accommodations.</p> <p>Exemption from Resident Withholding Tax.</p> <p>Exemption from Fringe Benefit Tax for charity's employees.</p> <p><u>Donee Organization</u> Exemption of donations from income tax.</p>	<p><u>Individuals</u> Tax credit of 33 1/3% or \$500 (whichever is less) for cash donations of \$5 (NZ) or over.</p> <p><u>Corporations</u> Deductions against corporate income tax of cash donations to:</p> <p>1) single approved charities or donee organizations</p> <p>2) multiple approved charities or donee organizations.</p> <p>Deduction from corporate income tax payable of business expenses for sponsorships of artistic or sports events.</p>	<p>\$500 annually.</p> <p>1) 1% of company income or \$4,000 (whichever is greater)</p> <p>2) 5% of company income or \$1,000 (whichever is greater)</p> <p>Payments must be more than \$100 per annum.</p>

<b>Tax Treatment of Charities and Donors International Comparison</b>			
<b><u>Mexico</u></b>	<b><u>Charities</u></b>	<b><u>Donors</u></b>	<b><u>Ceilings</u></b>
	Income tax exemption for donations.	<u>Individuals</u>	Unknown.
	Limited exemptions for income from rental fees, dividends, interest or royalties.	Deduction from income of total amount of donations to recognized charities.	
	Exemption from sales tax on products manufactured by charities and sold directly by them.	<u>Corporations</u>	Unknown.
		Deduction from profits of total amount of donations to recognized charities.	

<b>Tax Treatment of Charities and Donors International Comparison</b>			
<b><u>Japan</u></b>	<b><u>Charities</u></b>	<b><u>Donors</u></b>	<b><u>Ceilings</u></b>
	Exemption from income tax of income from:	<u>Individuals</u>	Up to 25% of gross income.
	- donations	Income tax deduction for donations exceeding 10,000 yen to qualified charities (as determined by Ministry of Finance).	
	- investment income		
	- profit-oriented activities (up to 30% of total income - beyond limit tax rate is 27%)	Deduction of out-of-pocket expenses for services rendered to charities.	
	Exemption of some charities from prefectural or municipal taxes.	<u>Corporations</u>	No ceiling.
		Income tax deduction for donations to qualified charities (as determined by Ministry of Finance).	