True North in Canadian public policy

HARMING CHARITY: The Potential Effects of High Personal Income Tax Rates on Charitable Giving

Sean Speer

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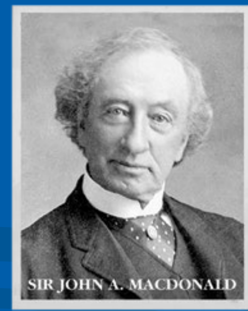

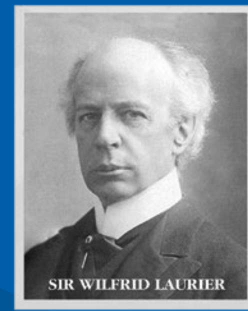

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I wanted to thank William Lundy for his help in the research and writing of this report. –SCS

Executive Summary

Canada's high-income earners have experienced a number of increases to their personal income tax rates at the federal and provincial levels over the past several years. These tax rate increases have been principally motivated by concerns about fairness: those who "can afford it" are being asked to pay more. The government has found that increasing taxes on high-income earners is popular with the general public, but a wide body of research finds that higher tax rates can impose economic costs, most notably in the form of less entrepreneurship, investment, and work.

There has been less attention paid to the potential adverse effects on charitable giving. The same high-income earners who have been targeted to "do a little more" in the form of tax increases are disproportionately responsible for philanthropy and charitable giving in Canada. These "super donors" who earn $150,000 or more represent only 9 percent of all charitable donors but have consistently provided about 40 percent of the total value of charitable donations across the country. It is important therefore that policy-makers understand the relationship between tax policy and charitable giving for this cohort which plays such a significant role in financing Canada's charitable sector.

Because of the charitable sector's clear and measurable benefits, Canadian tax policy rewards charitable giving in the form of tax benefits. Charitable giving contributes to the "public good" and so public policy has long supported individual and corporate donations. But donors have different and varied motivations for giving and the interaction between marginal tax rates and tax credits for donors is complex.

> "The relationship between taxation and charitable giving is complicated. It is partly affected by the role of average tax rates and their effect on after-tax income

More than 5.4 million Canadians donate to charities each year. However, the number of donors has been falling each year since 2010 when we started to see higher tax rates for "super donors." In 2016 alone, the total value of charitable donations made by those earning $150,000 and more fell by 6 percent. It is difficult to know what caused this drop in charitable giving. Slow economic growth in Alberta was certainly a major factor. But 2016 is also the year in which the federal government's new top marginal rate for those earning over $210,000 came in to effect.

The relationship between taxation and charitable giving is complicated. It is partly affected by the role of average tax rates and their effect on after-tax income. It is also influenced by the interaction between marginal tax rates and charitable tax benefits. The former, known as the "income effect," suggests that a higher tax burden and lower after-tax income can lead to less charitable giving. The latter, known as the "price effect," implies that the interaction between high marginal tax rates and charitable tax benefits can actually produce more charitable giving. In the end, contributions are determined by a combination of how much we earn and how costly it is to give. Basically the debate comes down to whether people give more if it is cheaper to donate or when they have more disposable income.

This paper looks at some of the academic scholarship that attempts to answer whether the income effect or the price effect is the more influential in determining levels of philanthropic giving. An increasing body of US-based analysis has come to recognize the importance of changes to after-tax income in influencing charitable giving. Several Canadian studies have also found a positive relationship between changes to income and changes in the level of charitable giving.

On balance, academic scholarship generally points in the direction of "price effect" being a determinant in charitable giving. But there is certainly evidence that tax-induced changes in income can also affect charitable giving particularly over the long-term.

Tax policy changes that discourage "super donors" from charitable giving could reduce the resources available to charities and, in turn, harm their ability to contribute to society's general welfare. The question then arises: If higher and higher tax rates can harm both the economy and civil society, is the price worth paying?

Sommaire

Les contribuables canadiens à revenu élevé ont subi plusieurs hausses de leur taux d'impôt personnel aux paliers fédéral et provincial au cours des dernières années. Ces hausses ont été imposées principalement pour des questions d'équité : on demande à ceux qui « en ont les moyens » de contribuer davantage. Si le gouvernement a jugé que les impôts supplémentaires sur les gros revenus avaient la faveur du public, de nombreuses recherches montrent pourtant que les taux d'imposition supérieurs sont susceptibles d'imposer des coûts économiques, notamment en décourageant l'investissement et l'esprit d'entreprise et en réduisant les heures travaillées.

On s'est moins intéressé aux effets négatifs potentiels des hausses d'impôts sur les dons de bienfaisance. Les particuliers à revenu élevé qui ont été ciblés pour « faire un peu plus » contribuent de manière disproportionnée à la philanthropie et aux œuvres de bienfaisance au Canada. Ces « super donateurs » qui gagnent 150 000 $ ou plus ne représentent que 9 % de tous les donateurs, mais fournissent environ 40 % de la valeur totale des dons amassés dans l'ensemble du pays. Il est donc important que les décideurs comprennent le lien entre la politique fiscale et le rôle central joué par cette cohorte dans le financement du secteur des organismes de bienfaisance au Canada.

> « La relation entre la fiscalité et les dons de bienfaisance est difficile à établir avec certitude. Elle dépend d'une part des taux d'imposition moyens et de leur incidence sur le revenu après impôt et, d'autre part, de l'interaction entre les taux d'imposition marginaux et les avantages fiscaux procurés par les dons.

En raison des bienfaits clairs et mesurables apportés par le secteur caritatif, la politique fiscale canadienne encourage les dons au moyen d'incitatifs fiscaux. Les dons de bienfaisance contribuent au « bien public » et c'est pourquoi les politiques publiques soutiennent depuis longtemps les dons des particuliers et des entreprises. Or, les motivations des donateurs sont différentes et variées, de sorte que l'interaction entre les taux d'imposition marginaux et les crédits d'impôt est difficile à établir.

Plus de 5,4 millions de Canadiens font des dons à des œuvres de bienfaisance annuellement. Cependant, le nombre de donateurs est en baisse chaque année depuis 2010, moment où la cohorte des « super donateurs » a commencé à subir des taux d'imposition plus élevés. En 2016 seulement, la valeur totale des dons de bienfaisance provenant de particuliers gagnant 150 000 $ et plus a diminué de 6 %. Il est difficile d'établir avec certitude la cause de cette baisse, même si l'on peut supposer que le ralentissement économique en Alberta a certainement joué un rôle majeur. Ce que l'on a observé cette année-là, en revanche, c'est l'entrée en vigueur du nouveau taux marginal d'imposition maximal applicable aux particuliers gagnant plus de 210 000 $.

La relation entre la fiscalité et les dons de bienfaisance est difficile à établir avec certitude. Elle dépend d'une part des taux d'imposition moyens et de leur incidence sur le revenu après impôt et, d'autre part, de l'interaction entre les taux d'imposition marginaux et les avantages fiscaux procurés par les dons. Le premier facteur, connu sous le nom d'« effet de revenu », suppose qu'un fardeau fiscal plus élevé et un revenu après impôt plus faible exercent une pression à la baisse sur les dons de bienfaisance. Le deuxième facteur, appelé « effet de prix », laisse plutôt croire que l'interaction entre les taux d'imposition marginaux élevés et les avantages fiscaux procurés par les dons entraîne une hausse des dons. En fin de compte, les contributions sont déterminées en fonction d'une combinaison de ces facteurs : le montant de nos revenus et le coût de nos dons. Fondamentalement, le débat porte sur la question de savoir si les gens manifestent plus de générosité lorsque leurs dons leur coûtent moins cher ou lorsqu'ils disposent de plus de revenus après impôt.

Dans cet article, on examine certaines recherches universitaires qui tentent de déterminer lequel des deux effets (de revenu ou de prix) a le plus d'incidence sur le niveau des dons philanthropiques. Un nombre croissant d'analyses basées aux États-Unis confirment l'influence déterminante des changements apportés au revenu après impôt. Plusieurs études canadiennes ont également démontré qu'un changement dans le revenu entraîne un changement dans le niveau des dons de bienfaisance.

Dans l'ensemble, les travaux universitaires indiquent généralement que « l'effet de prix » est un facteur déterminant en matière de dons de bienfaisance. Toutefois, il existe certainement des preuves du fait que les changements dans le revenu attribuables à l'impôt peuvent également influer sur les dons de bienfaisance, en particulier sur une longue période.

Les changements de politique fiscale qui découragent les « super donateurs » pourraient abaisser les ressources disponibles des organismes de bienfaisance et nuire du même souffle à leur capacité de contribuer au bien-être général de la société. La question qui se pose alors, c'est de savoir si des taux d'impôt de plus en plus élevés peuvent nuire à la fois à l'économie et à la société civile. Au bout du compte, il faut se demander si le « jeu en vaut la chandelle ».

Introduction

Canada has experienced a series of increases to personal income tax rates for high-income earners at the federal and provincial levels over the past several years. Seven of 10 provinces now have combined top marginal tax rates exceeding 50 percent (Speer 2017a). The others are close.

These tax rate increases on high-income earners have been principally motivated by concerns over fairness. Prime Minister Trudeau has regularly spoken about "asking wealthy Canadians to do a little more" (Liberal Party of Canada 2015). Finance Minister Bill Morneau's 2016 budget speech also focused on fairness and the need to "ask those who can afford it to pay a little more" (Morneau 2016). Provincial policy-makers have made similar arguments.

This trend of increasing taxes on high-income earners, which polling has shown is popular with the general public, has received considerable policy and political attention in recent years (Siekierski 2017). Past Macdonald-Laurier Institute research has analysed the possible broad economic effects of rising marginal tax rates (Speer 2017b). Other scholars have examined the implications for economic competitiveness (Bazel, Mintz, and Thompson 2018), the consequences for entrepreneurship and investment (Fraser Institute 2018), the effects on work and employment (Laurin 2018a), and the revenue implications (Laurin 2018b). There is some disagreement about the magnitude, but few dispute that higher tax rates for high-income earners impose economic costs in the form of less entrepreneurship, investment, and work.

> "Few dispute that higher tax rates for high-income earners impose economic costs in the form of less entrepreneurship, investment, and work.

The consensus is sufficiently broad to include long-time Republican economic adviser Martin Feldstein (1994) and former Obama administration adviser Christina Romer (Romer and Romer 2012) in the United States and leading tax experts Jack Mintz (2018) and Kevin Milligan (Milligan and Smart 2014) in Canada. This research does not mean there are not arguments in favour of high tax rates or redistribution. But it is important that policy-makers are cognizant of the efficiency-equity trade-offs and the possible costs and limits of rising tax rates on high-income earners.

One area of analysis that is often overlooked is the relationship between high personal income tax rates and philanthropy and charitable giving, and the extent to which changes in tax rates may help or harm it. Presently these hidden (and human) costs of higher tax rates are neglected in the development of government policy and tax policy debates. Policy-makers need to understand the relationship between personal income tax rates and philanthropy so that when they decide to raise taxes, they understand and accept the full economic and social consequences of that decision – particularly as it relates to charitable giving. This paper begins to examine this relationship in more depth.

Why is the link between high-income earners and charity so important? The same high-income earners who have been targeted to "do a little more" in the form of tax rates increases are disproportionately responsible for philanthropy and charitable giving in Canada. Ten percent of donors contribute

66 percent of overall donations and accounted for 83 percent of the growth in charitable donations in Canada between 2004 and 2013 (Turcotte 2015a). Nearly two-thirds of these "primary donors" (as Statistics Canada describes them) are in the top two income quintiles (see table 1) (Turcotte 2015b).

TABLE 1: PRIMARY DONORS, OTHER DONORS AND NON-DONORS BY PERSONAL INCOME QUINTILE (%), 2013

Personal Income Quintile	Primary Donors	Other Donors	Non-Donors
Lowest Quintile	8	19	32
Second Quintile	14	19	27
Third Quintile	19	21	17
Fourth Quintile	22	21	15
Highest Quintile	36	21	10

Source: Turcotte 2015b.

But even this fails to fully capture the disproportionate role that a small number of high-income earners play in supporting and sustaining Canada's charitable sector. Those earning $150,000 or more represent only 9 percent of all charitable donors but have consistently provided about 40 percent of the total value of charitable donations across the country (Canada Revenue Agency Undated).

Policy-makers need to understand the extent to which higher tax bills for these "super donors" harm charitable giving. If they do not, the risk is that financial resources that would have gone to charities and other civil society organizations are instead directed to government coffers. This tax-induced "crowding out" of charitable giving can have negative effects on general welfare.[1] Society may be worse off when this happens because charitable organizations can in some cases deliver better results than government-run programs and services.

This paper aims to draw on the current body of research and analysis in this area to better understand how individuals in general, and high-income earners in particular, alter their charitable giving in response to tax policy changes.

We find that the relationship between taxation and charitable giving is complicated for several reasons including:

- The motivations of donors are multi-faceted and might be related to tax planning, income levels, religious views, community solidarity, and so on.
- The interaction between one's marginal tax rates and tax preferences related to charitable giving (such as the Charitable Donation Tax Credit) lowers the "price" of donations and can thus provide an incentive for charitable giving even if after-tax income falls.
- The relative role of the "price" of giving and a donor's income can differ among different donor and income groups.
- Evolving research methodologies and data sources are producing new and dynamic results about how donors respond to price and income changes including transient and long-term effects.

On balance, academic scholarship generally points in the direction of a "price effect" being a determinant in charitable giving. But there is certainly evidence that tax-induced changes in income can also affect charitable giving – particularly for "primary donors" and, by extension, "super donors."

Background On Charitable Giving In Canada

Canada's charitable sector is a rich and dynamic contributor to our general welfare. There are roughly 85,000 registered charities across the country (Sector Source Undated). These organizations and their employees, volunteers, and donors are involved in various social causes ranging from education to health care, social services, religious institutions, and so on.

Many of these organizations do tremendous work. There is evidence that the charitable or civil society model can do a better job than government at improving people's lives (Husock 2015). Charities tend to be nimbler, more humane, and more focused on the individual than large-scale, bureaucratic models. It is no surprise, therefore, that there are various examples of civil society-based institutions outperforming government ones. And this does not even account for the positive benefits to one's well-being that can flow to individuals who donate and volunteer.

As just one example, MLI has previously highlighted the case of privately-sponsored refugees outperforming government-assisted ones here in Canada (Leuprecht and Speer 2015). Foreign aid is another case where organizations such as the Gates Foundation seem to be producing better results than decades of government programming and spending in the developing world (Washington Times 2007). A third case is the Canadian-based Pathways to Education; new research is showing the positive effects of its innovative, community-based, mentorship model on disadvantaged youth (Lavecchia, Oreopoulos, and Brown 2019). The list goes on and on. The charitable sector is an essential part of Canada's economic and social landscape. It powerfully leverages private means for public ends and is worth protecting, sustaining, and strengthening as a matter of public interest and public policy.

It is because of the charitable sector's clear and measurable benefits that Canadian tax policy rewards charitable giving in the form of tax benefits. Charitable giving contributes to the "public good" and so public policy has long supported individual and corporate donations (Horpedahl 2016) That is the essential reason that we indirectly subsidize charitable giving through the tax system as opposed to other private activities that may produce positive benefits for the individual but do not necessarily contribute to the broader public good.

Charitable donations in Canada are presently eligible for two-tiered federal and provincial credits.[2] These tax credits are set at a lower rate for donations below $200 and at a higher rate for donations exceeding $200. In general, the tax credit for donations above and below $200 is set equal to the jurisdiction's highest and lowest personal income tax rates, respectively.

The federal credit is equal to 15 percent for donations below $200, and 29 percent in general for donations in excess of $200. Individuals with income taxed at the top federal rate of 33 percent, however, can claim a charitable tax credit of 33 percent for donations up to the amount that their taxable income exceeds $205,842, the threshold at which the top federal tax rate starts to apply (Canada 2017a).[3] Similarly, in Quebec, donations above $200 are eligible for a tax credit of 24 percent, although individuals with income taxable at the 25.75 percent rate can claim a matching charitable tax credit valued at 25.75 percent.

As we have witnessed a series of changes to top personal income tax rates in Canada, most governments have tended to also change the value of their charitable tax credits for donations above $200.

Changes to the value of these tax credits have been enacted to minimize or neutralize the negative effects that higher tax rates may have on charitable giving. When the British Columbia government recently added a new top income tax rate (now in addition to the previous top rate of 14.70 percent), for instance, the charitable tax credit for donations in excess of $200 was increased from 14.70 percent to 16.80 percent (British Columbia Undated). Similarly, when Saskatchewan reduced its bottom rate from 10.75 percent to 10.50 percent in 2018 and its top rate from 14.75 percent to 14.50 percent, the tax credit rates for 2018 were reduced to 10.50 percent and 14.50 percent for donations below and above $200, respectively.

But it is not always the case that charitable tax credits are kept in step with tax rate changes. There have also been a number of instances where provincial governments have raised their top income tax rates without correspondingly increasing the value of their charitable tax credit. New Brunswick increased its top rate from 17.95 percent to 20.30 percent between 2015 and 2016 but left its tax credit for donations above $200 unchanged at 17.95 percent (New Brunswick, Finance and Treasury Board Undated). Similarly, Ontario increased its top rate from 11.16 percent to 12.16 percent in 2012, and again to 13.16 percent in 2013, but left its tax credit for donations above $200 unchanged at 11.16 percent (TaxTips.ca 2019a, 2019b). Yukon added a new top bracket of 15 percent in 2015 but only raised the charitable tax credit rate to 12.80 percent for donations above $200 (Yukon 2018, TaxTips.ca 2017).

Some jurisdictions have tax credits that are more generous than the corresponding bottom and top personal income tax rates. Alberta, for instance, has a tax credit of 21 percent for donations above $200, compared to a top income tax rate of 15 percent. Quebec also has a tax credit equal to 20 percent for donations below $200, compared to bottom income tax rate of 15 percent. Table 2 provides an overview of the top and bottom personal income tax rates and the value of the charitable tax credits across the country.

TABLE 2: LOWEST AND TOP PERSONAL INCOME TAX RATES IN CANADA AND CHARITABLE TAX CREDIT RATES FOR THE FEDERAL AND PROVINCIAL GOVERNMENTS, 2018^

JURISDICTION	TAX CREDIT – BELOW $200	TAX CREDIT – ABOVE $200	LOW INCOME TAX RATE	TOP INCOME TAX RATE
CA	15.00%	29.00%*	15.00%	33.00%
AB	10.00%	21.00%	10.00%	15.00%
BC	5.06%	16.80%	5.06%	16.80%
MB	10.80%	17.40%	10.80%	17.40%
NB	9.68%	17.95%	9.68%	20.30%
NL	8.70%	18.30%	8.70%	18.30%
NS	8.79%	21.00%	8.79%	21.00%
NT	5.90%	14.05%	5.90%	14.05%
NU	4.00%	11.50%	4.00%	11.50%
ON	5.05%	11.16%	5.05%	13.16 %
PE	9.80%	16.70%	9.80%	16.70%
QC	20.00%	24.00%**	15.00%	25.75%
SK	10.50%	14.50%^^	10.50%	14.50%
YT	6.40%	12.80%	6.4%	15.00%

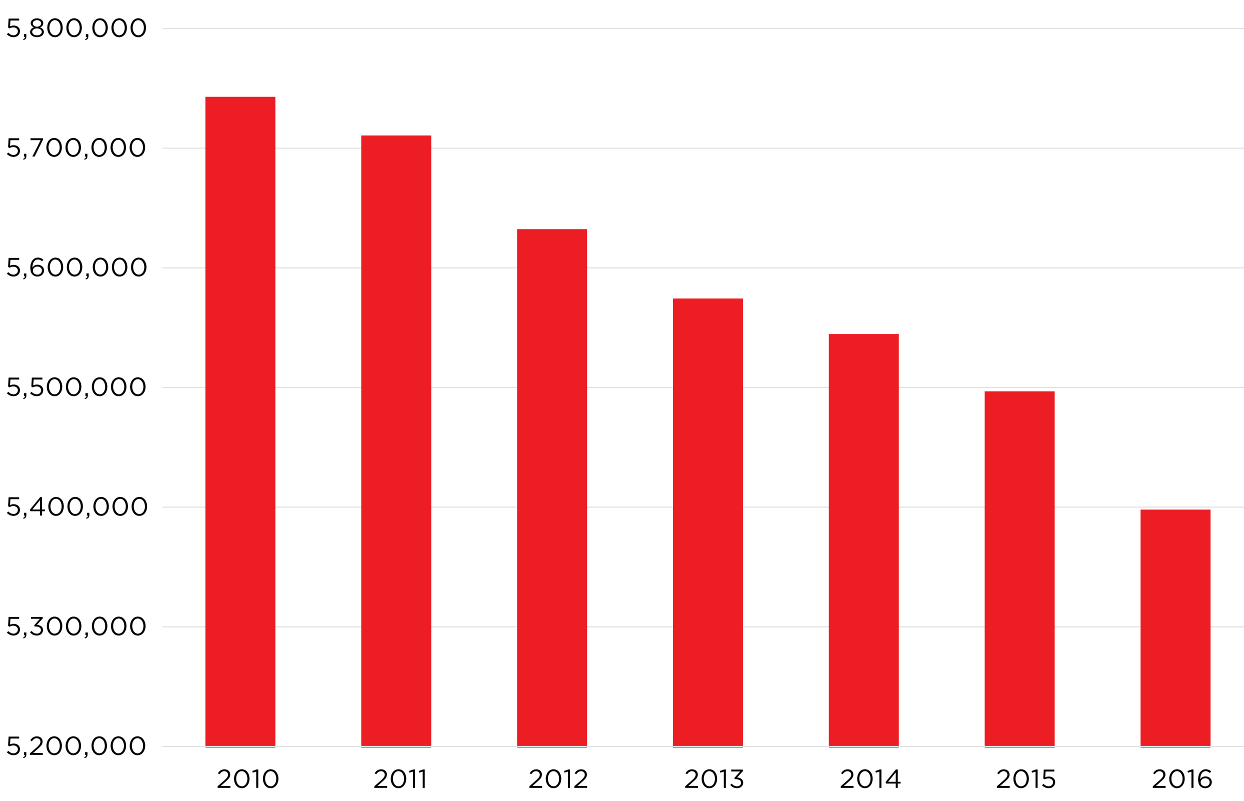
^ *Source: Canada 2017b, Canada 2019.*
**Rate of 33% applies for individuals with income taxable at 33 percent rate.*
***Rate of 25.75% applies for individuals with income taxable at 25.75 percent rate.*
^^ *Source: TaxTips.ca 2018.*

The interaction between tax rates and tax benefits is highly relevant to understanding how individuals adjust their charitable giving in response to tax changes. We will return to this issue in greater detail in the next section.

But before we do, it is important to briefly consider the state of charitable giving in Canada, including recent trends and the role of "super donors." Analysing how tax policy encourages or discourages charitable giving requires that we understand who gives and what motivates them to do so.

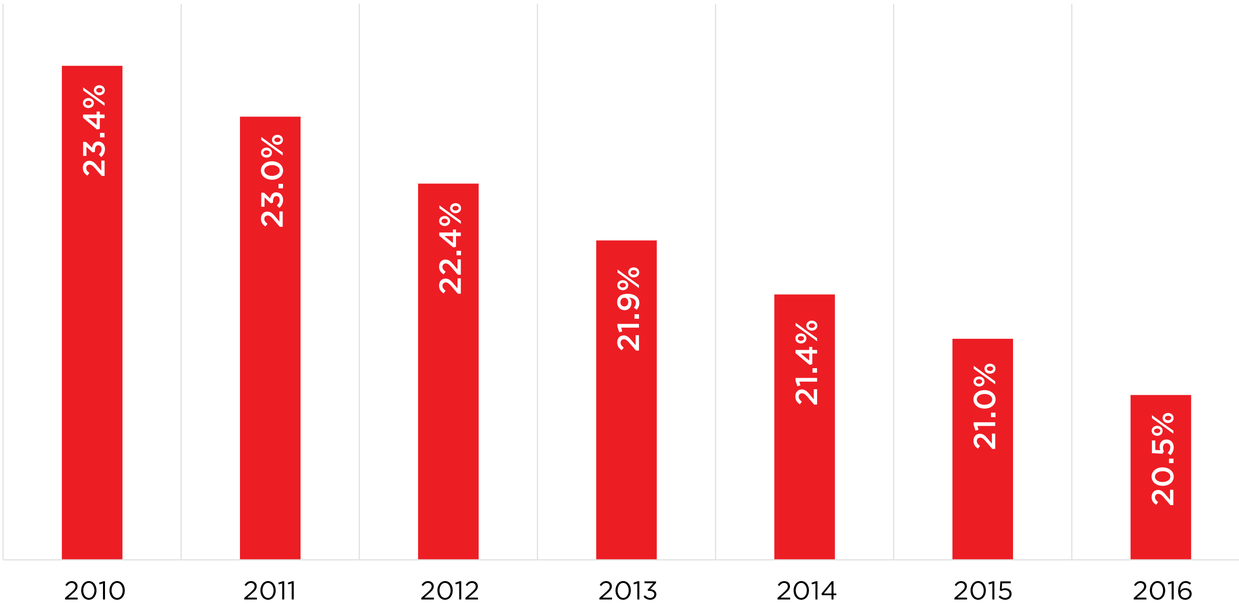
Approximately 5.4 million Canadians donated $8.9 billion in 2016 (Statistics Canada 2018a). Both the number of donors and the total value of donations were down year-over-year from 2015. The number of donors has in fact been falling each year since 2010 when we started to see higher tax rates for "super donors." (Figure 1 shows the number of donors from 2010 to 2016 and figure 2 indicates the share of tax filers who claimed the Charitable Donation Tax Credit during this period). But since 2013, the drop in the number of donors has typically been offset by higher overall donation amounts. (Figure 3 gives the total value of charitable donations from 2010 to 2016). These data are based on those who claimed donations to registered charities on their tax returns. The figures do not capture those who may make charitable donations but do not claim any tax credits.

FIGURE 1: NUMBER OF CHARITABLE DONORS IN CANADA, 2010-2016



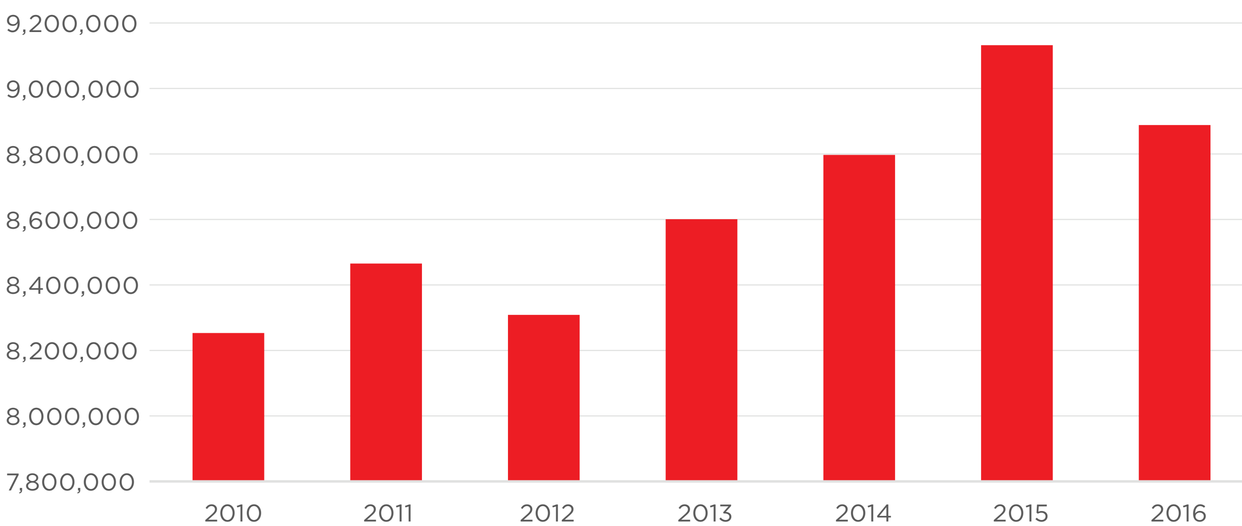
Source: Statistics Canada 2018b.

FIGURE 2: SHARE OF TAX FILERS WHO REPORTED DONATIONS, 2010-2016



Source: Statistics Canada 2018b.

FIGURE 3: TOTAL VALUE OF CHARITABLE DONATIONS IN CANADA, 2010-2016 (X $1,000)



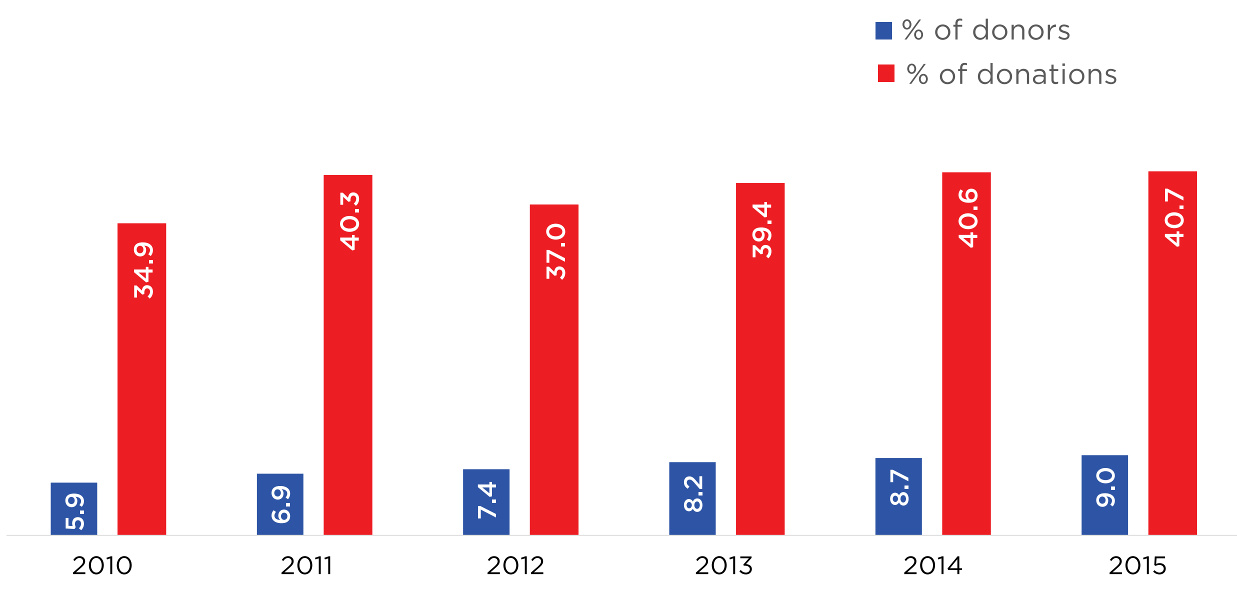
Source: Statistics Canada 2018b.

These aggregate trends are interesting, but they have their limits. Remember charitable giving is mostly driven by a small number of what Statistics Canada calls "primary donors." More than two-thirds of charitable donations are in fact made by the top 10 percent of donors (Turcotte 2015c). This same group is responsible for 83 percent of the overall increase in charitable donations between 2004 and 2013. These are the individuals that policy-makers need to focus on to understand their motivations, incentives, and how changes in public policy affect their donation decisions. There are some common characteristics among these high-giving donors. Evidence shows that they tend to be older, university educated, religiously affiliated, and wealthy (Turcotte 2015c).

Income is indeed closely linked to charitable giving. The evidence shows that Canadians who earn more tend to donate more in absolute dollars to charity. This is intuitive – especially since 70 percent of people report that limited financial resources are the principal reason that they do not donate or cannot donate more (Turcotte 2015c).

Those earning $150,000 and more are disproportionately responsible for charitable giving in Canada. If the top 10 percent of donors (irrespective of income) are the "primary donors," those earning at least $150,000 are what we have termed "super donors" for the purposes of our analysis. This group comprises just over 500,000 people but in 2015 it donated $4.03 billion (Canada Revenue Agency Undated). This means that this cohort represents 9 percent of the total number of donors and 40.7 percent of overall donations in Canada. And it would be wrong to assume that 2015 was somehow an anomaly. The small share of Canadians earning $150,000 and over have consistently contributed a significant share of overall donations in Canada (see figure 4).

FIGURE 4: SHARE OF THOSE EARNING $150,000 AND OVER AMONG DONORS AND OVERALL DONATIONS, 2010-2015

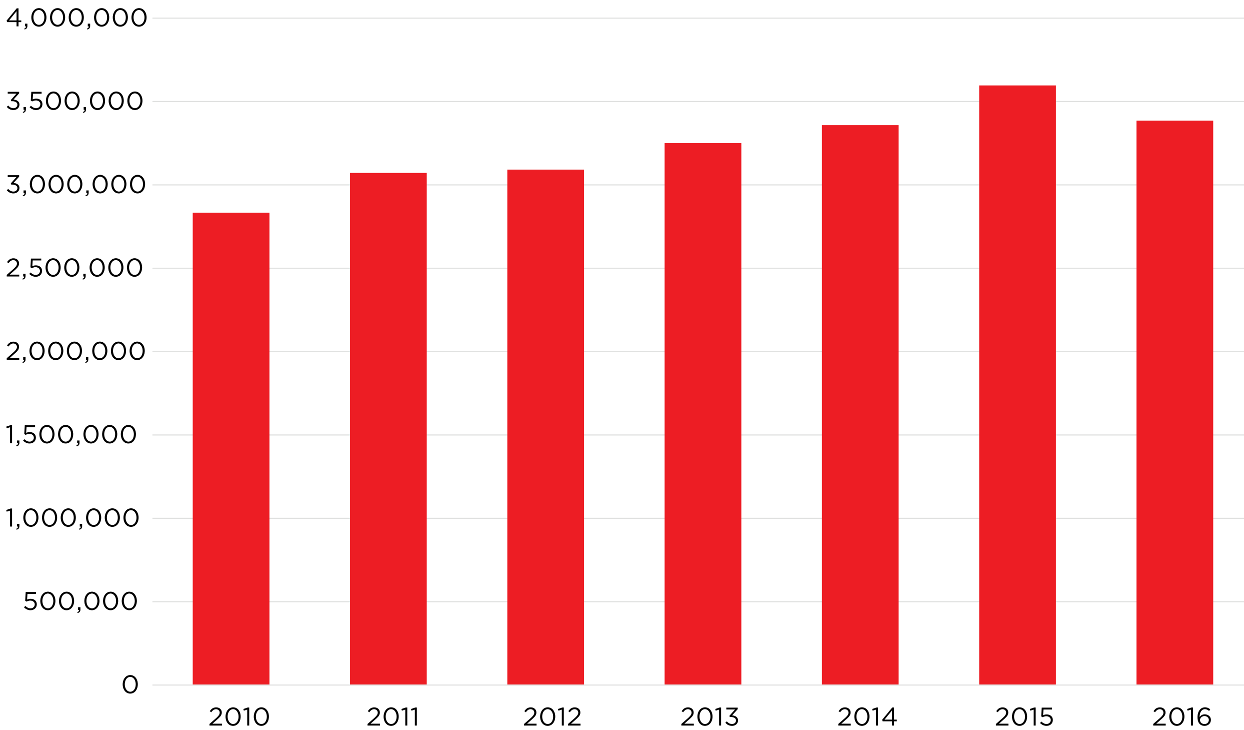


Source: Canada Revenue Agency Undated.

It is a good sign that more than 5.4 million Canadians donate to charities each year. But again it is important to focus on the small cohort of "super donors" that punches well above its weight sustaining and strengthening Canada's charitable sector. Policy-makers need to understand what drives this group's philanthropic decision-making and ensure these considerations are part of tax policy development.

It is notable, therefore, that the total value of charitable donations made by those earning $150,000 and more fell by 6 percent in 2016 (see figure 5). It is difficult to know what caused this drop in charitable giving. Slow economic growth in Alberta was certainly a major factor. But 2016 is also the year in which the federal government's new top marginal rate for those earning over $210,000 came in to effect.

FIGURE 5: TOTAL VALUE OF CHARITABLE DONATIONS BY THOSE EARNING $150,000 AND OVER, 2010-2016 (X 1,000)



Source: Canada Revenue Agency Undated.

Policy-makers should consider whether and how higher tax rates on this cohort may negatively affect charitable giving and, with it, Canada's whole charitable sector. We need to understand the extent to which these tax increases depress charitable giving by "super donors" and how the drop in revenue may harm civil society by limiting its provision of programs and services to Canadians.

The Relationship Between Personal Income Tax Rates And Charitable Giving

There is a wide body of evidence on the negative economic effects of high income tax rates, including on high-income earners. These ideas and concerns are a regular part of Canada's policy and political debates. The possible effects of high personal tax rates on charitable giving, however, are mostly excluded from such debates.

We have shown thus far that the number of charitable donors and the total value of charitable giving in Canada is holding steady or falling in recent years. These trends have generally tracked the same period in which we have witnessed rising tax rates for high-income earners at the federal and provincial levels. But while these data are suggestive about the possible link between taxation and policy, correlation is not causation and they are hardly dispositive observations.

INCOME EFFECT VS. PRICE EFFECT

The basic idea of the *income effect* is that charitable giving is tied to disposable income. That higher taxes reduce after-tax incomes means that, all things being equal, charitable giving will fall accordingly.

The basic idea of the *price effect* is that the interaction between marginal tax rates and the value of charitable tax benefits can enable donors to reduce their tax liability and in so doing lower the "price" of the donation. Suppose someone earning $210,000 claims a $700 donation. He or she is thus able to reduce his or her tax liability by $195 (15 percent on the first $200 and 33 percent on the second $500). This means that the donation's net cost is only $505 and his or her tax bill is reduced accordingly.

Many factors contribute to an individual's decision to donate to charities. Religious affilation, social norms, altruism, and so on (see Vesterlund 2006). We do not dispute that choices are multi-faceted. Our principal focus here, though, is the role of tax policy and its effect on the "price" of giving and changes to after-tax income.

The relationship between taxation and charitable giving is complicated. It has two dimensions. The first is the role of average tax rates and their effect on after-tax income and, in turn, charitable donations. The second is the interaction between marginal tax rates and charitable tax benefits and the effect on charitable donations. The former, known as the "income effect," suggests that a higher tax burden and lower after-tax income can lead to less charitable giving. The latter, known as the "price effect," implies that the interaction between high marginal tax rates and charitable tax benefits can actually produce more charitable giving if the price of giving falls.

The existing scholarship on the relationship between taxation and charitable giving tends to be divided between those who find that the "income effect" has a primary influence on charitable giving and those who find that the "price effect" has a greater impact. This debate thinks about charitable giving just like the purchase of any other commodity. Contributions are determined by a combination of how much we earn and how costly it is to give. Basically the debate comes down to whether people give more if it is cheaper to donate or when they have more disposable income.

The academic literature offers a range of conclusions that vary based on the given data set, research design, and empirical parameters. New econometric methods have enabled researchers to drill down further into these questions. On balance, the research still probably points in the direction of a "price effect." But there is certainly evidence that tax-induced changes in income can also affect charitable giving – particularly for "primary donors" and, by extension, "super donors."

The earliest scholarship on this question seems to date back to 1967. A series of studies from the 1970s tended to find high price elasticities and relatively low income elasticities. Typical estimates include those of Feldstein and Taylor (1976) who found a price elasticity between -1.09 and -1.28 and an income elasticity of around 0.7 (Feldstein and Taylor 1976). This means that a 1 percent increase in the price of charitable giving reduces giving by a bit more than 1 percent. Putting it more bluntly: each dollar of tax revenue lost to government via a charitable tax preference can generate an additional dollar of charitable giving.

An emphasis on the role of price has pervaded the economic analysis of charitable giving and how public policy in general, and tax policy in particular, influences donor behaviour. A 1990 literature survey by Steinberg (1990) found that most studies up to that point found a greater role for price than income.

> "An emphasis on the role of price has pervaded the economic analysis of charitable giving and how public policy in general, and tax policy in particular, influences donor behaviour.

Many of these studies use a cross-sectional methodology that models charitable giving based on statistics for taxpayers from a single year. One limitation with this approach is that it is not able to estimate the difference between short- and long-run effects of changes in income and changes in price. Individuals may treat transient changes in income or price differently from more permanent changes and may shift planned giving from certain years to other years in order to take advantage of more favourable tax treatment. Additionally, unlike panel data that track the same individuals over time, cross-sectional studies cannot control for personal characteristics that are not reported in tax data but which affect charitable giving and remain fairly constant over time, such as education or religion.

Newer scholarship has generally focused more on the "income effect." Economists and scholars who subscribe to this approach have used different methodologies (including longitudinal analysis) to measure what is called the "income elasticity of charitable giving." It aims to measure the changes in charitable donations that would result, all things being equal, from a 1 percent increase or 1 percent decrease in income.

A series of US-based studies, for instance, have used dynamic models to take into account the effects of anticipated future changes in the "price" of charitable donations. They have tended to find income elasticities that are higher than price effects. These studies include Ricketts and Westfall (1993), Randolph (1995), Barrett, McGuirk, and Steinberg (1997), Wu and Ricketts (1999), and Bakija (2000). Bakija and Helm (2011), who find a relatively large price-based effect, is a notable exception.

Our research finds that, after accounting for both temporary and dynamic effects, an increasing body of US-based analyses has come to recognize the importance of changes to after-tax income in influencing charitable giving. Put more simply: many US studies are finding that changes in income generally have a meaningful impact on charitable giving. This is consistent with analysis by Canada's Department of Finance which similarly finds that "studies have generally found that the income elasticity of donations is positive, indicating that the average value of giving increases with income" (Canada, Department of Finance 2015).

> "Put more simply: many US studies are finding that changes in income generally have a meaningful impact on charitable giving.

This body of research similarly points in the direction of different income effects for different donors. Past research focused on the income and price elasticities for the average donor. Newer research has tended to investigate the effects for different donor groups. This is important since there is significant heterogeneity in donor behaviour, even among those in the same income levels. A study by Auten, Sieg, and Clotfelter (2002), for instance, which is based on US tax-filer data, found that the top 5 percent of donors in each income group accounted for between 25 and 45 percent of all donations in each respective group (Auten, Clotfelter, and Schmalbeck 2002).

Estimating income and price elasticities for the average donor rather than for different donors may have misleading policy implications if the small number of donors who account for the vast majority of donations exhibit a different response than typical donors (Grant 2016). This is a key point given that the recent raft of tax rate increases has tended to target high-income earners rather than tax-filers at large.

International studies that focus on "primary donors" tend to find that the top 10 percent of donors are less sensitive to changes in the after-tax price of giving in absolute and relative terms to other donor groups, and significantly more responsive to changes in income than in price. These studies include Fack and Landais (2010), Lin and Lo (2012), and Grant (2016). The main takeaway from these sample studies is that the responsiveness to changes in income seems to be more marked among the most generous donors. This is a highly relevant insight for the purposes of understanding the possible effects of tax policy changes on "super donor" behaviour. The behavioural response of an average donor is less relevant than the behavioural response of major donors given their disproportionate role in financing the charitable sector. And the evidence generally points to "super donors" being more highly sensitive than average donors to changes in after-tax income – including changes driven by tax policy.

One final subject of analysis in the literature on taxation and charitable giving focuses on the macroeconomic effects of tax policy and its impact on wealth creation and charitable donations. High tax rates can harm economic activity and wealth creation which in turn can reduce the prospective pool of affluent donors and their capacity to give over time. Notwithstanding the short- or even medium-term price effect, if the long-term result is to reduce the growth of donor incomes, then the overall effect on charitable giving can still be negative. The flipside is also true, of course. If tax policy contributes to higher income growth and so enlarges the prospective pool of affluent donors, it can contribute to higher levels of charitable giving over time.

The US experience in the 1980s seems illustrative of these broader environmental considerations. The top federal income tax rate was reduced from 70 percent to 50 percent in 1981 and again from 50 percent to 28 percent in 1986. The net effect of these marked tax reductions was to raise the after-tax cost of giving. Why? The marginal tax benefit of using charitable giving to shield one's tax bill was diminished. So, according to the price effect theory, charitable donations ought to have grown more slowly or even fallen. Yet total giving (including bequests and corporate donations) increased by 27 percent in real terms between 1979 and 1990 (Giving USA 2017). Giving by individuals increased by 32 percent in real terms over this period.

Some, such as Duquette (2016), assert that this increase in charitable giving and philanthropy occurred in spite of the Reagan-era tax cuts. The basic argument is that the tax reductions actually caused charitable giving to grow far below levels that would have been the case otherwise. However, this counterfactual rests on the somewhat implausible assumption that the Reagan tax cuts had no effect on income growth or the work and investment decisions of high-income earners.

This argument also does not hold with the evidence that the number of high-income earners who made charitable donations, including substantial donations, grew considerably following the tax rate cuts. Between 1979 and 1990, the total number of "itemizers" – that is, those who chose to complete an itemized tax return in order to claim various tax preferences such as the charitable tax deduction – increased by 96 percent among those earning between $200,000 and $1 million (in constant 1991 dollars) and by 245 percent for those earning in excess of $1 million (Auten, Cilke, and Randolph 1992).

Total giving from these income groups rose in real terms by 48 percent and 66 percent respectively over the same period (Auten, Cilke, and Randolph 1992). The number of donations exceeding $1 million in value (in 1991 dollars) also increased substantially from 418 in 1979 to 888 in 1990, with their value increasing from $904 million in 1979 to $2.3 billion in 1990. Measured in after-tax terms, the generosity of the top 1 percent of tax-filers rose from 2 percent of adjusted gross income in 1979 to 2.3 percent in 1994 (Auten, Clotfelter, and Schmalbeck 2002).

> "One final subject of analysis in the literature on taxation and charitable giving focuses on the macroeconomic effects of tax policy and its impact on wealth creation and charitable donations.

It is also worth noting that charitable giving as a share of GDP and disposable income remained stable throughout this period. The idea that the same levels of growth in charitable donations would have occurred without the expansion in economic activity enabled by the tax reductions is counter-intuitive. That disposable incomes grew, and charitable giving remained a stable share of disposable income, is telling. It seems to point in favour of the income effect or otherwise one would expect to have seen charitable donation as a share of disposable income fall.

What about Canada? The Canadian-based research has many similarities to US-based and international studies. Several Canadian studies have found a positive relationship between changes to income and changes in the level of charitable giving.[4] Estimates from these Canadian studies find that a 1 percent increase in income produces an increase in charitable giving ranging from between 0.283 and 1.20 percent, with a median around 0.68 percent.

As a key example: a 2016 study by the federal department of finance estimated an income elasticity of between 0.65 and 0.71. This means that a 1 percent change in income can produce a change in charitable giving of 0.65 to 0.71 percent. Table 3 summarizes the main findings of the various studies on the potential income elasticity of giving in Canada.

TABLE 3: INCOME ELASTICITY OF CHARITABLE GIVING ESTIMATED IN VARIOUS CANADIAN STUDIES

STUDY	SOURCE	ESTIMATED INCOME ELASTICITY
Hood et al. (1977)	Aggregate income and giving data, 1968-1973	0.52
Glenday et al. (1986)	Cross-sectional tax data, 1978-1980	0.5 to 0.62
Kitchen and Dalton (1990)	1982 Survey of Family Expenditure	1.05
Kitchen (1992)	1986 Survey of Family expenditure	0.80
Apinunmahakul and Devlin (2004)	1997 National Survey of Giving, Volunteering and Participating	0.8 to 1.2
Department of Finance (2016)	Tax data panel, 1997-2012	0.65 to 0.71
Hickey et al. (2017)	LAD Panel tax-filer data, 1983-2013	0.283 (all donors) 0.019 to 1.285 (by income level)

Source: Canada, Department of Finance 2016.

What does this all mean for policy-makers?

Our answer must start with a recognition that the relationship between taxation and charitable giving is complicated for several reasons including:

- The motivations of donors are multi-faceted and might be related to tax planning, income levels, religious views, community solidarity, and so on.
- The interaction between one's marginal tax rates and tax preferences related to charitable giving (such as the Charitable Donation Tax Credit) lower the "price" of donations and can thus be an incentive for charitable giving even if after-tax income falls.
- The relative role of the "price" of giving and a donor's income can differ among different donor and income groups.
- Evolving research methodologies and data sources are producing new and dynamic results about how donors respond to price and income changes including transient and long-term effects.

On balance, academic scholarship generally points in the direction of a "price effect" being a determinant in charitable giving. But there is certainly evidence that tax-induced changes in income can also affect charitable giving – particularly for "primary donors" and, by extension, "super donors."

Conclusion

Canadian governments have enacted a series of increases to personal income tax rates for high-income earners in the name of greater fairness and equity. Several reports and studies – including some published by the Macdonald-Laurier Institute – have warned about the potential economic costs of these tax increases. A wide body of evidence shows that high marginal tax rates can have harmful economic effects related to entrepreneurship, investment, and work. This well-established consensus about the inherent trade-offs between efficiency and fairness in taxation policy crosses the ideological spectrum. The relationship between high personal tax rates and their possible effects on philanthropy and charitable giving has, however, received less policy and political attention. But that does not mean it should be less relevant for policy-makers – especially since high-income earners tend to be disproportionately responsible for financing the charitable sector and its activities.

Statistics Canada refers to the 10 percent of donors who are responsible for 66 percent of total donations as "primary donors." Those Canadians earning over $150,000 are only 9 percent of donors but have consistently been responsible for 40 percent of overall donations. We have called them "super donors" for the purpose of our analysis.

Charitable and civil society organizations require donations so they can play their crucial role in various aspects of our civic and social life. Tax policy changes that discourage "super donors" from charitable giving could reduce the resources available to charities and, in turn, harm their ability to contribute to society's general welfare.

This paper has attempted to analyse the literature and data on the relationship between high personal tax rates and charitable giving and philanthropy. Its goal has been to broaden the public debate about the economic and social costs of high taxation and better inform tax policy decisions at the federal and provincial levels.

On balance, academic scholarship generally points in the direction of a "price effect" being a determinant in charitable giving. But there is certainly evidence that tax-induced changes in income can also affect charitable giving – particularly for "primary donors" and, by extension, "super donors." Specifically, lower after-tax income can adversely affect charitable giving in general, and that from "primary donors" and "super donors" in particular.

Policy-makers need to be sensitive about the potential negative effects of higher marginal tax rates on high-income earners and the impact those higher rates might have on charitable giving in Canada.

If higher and higher tax rates can harm both the economy and civil society, is the price worth paying? This paper concludes that it is not.

About the Author

Sean Speer is a Munk Senior Fellow at the Macdonald-Laurier Institute. He previously served in different roles for the federal government including as senior economic advisor to the Prime Minister and director of policy to the Minister of Finance. He has been cited by The Hill Times as one of the most influential people in government and by Embassy Magazine as one of the top 80 people influencing Canadian foreign policy. He has written extensively about federal policy issues, including personal income taxes, government spending, social mobility, and economic competitiveness. His articles have appeared in every major national and regional newspaper in Canada (including the *Globe and Mail* and *National Post)* as well as prominent US-based publications (including *Forbes* and *The American*). Sean holds an M.A. in History from Carleton University and has studied economic history as a PhD candidate at Queen's University.

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Endnotes

1 For more on the "crowding out" of charitable giving, see Brooks 2004; Payne 1998; Gruber and Hungerman 2007; and Andreoni and Payne 2011.

2 The federal government used to provide for a tax deduction whereby the value of the tax benefit depended on one's income. As part of a broader set of tax reforms in 1988 the government shifted to a tax credit whereby the value of the benefit depends on one's charitable donations in a given tax year. See Duff (2000).

3 For example, an individual with taxable income of $215,842 who donates $15,200 to charity will receive a tax credit of 15 percent on the first $200 of his donation, a tax credit of 33 percent on $10,000 of his or her donation – the amount by which his income exceeds $205,842 – and a tax credit of 29 percent on the remaining $5,000 of his or her donation.

4 See, for instance, Hood, Martin, and Osberg 1977; Glenday, Gupta, and Pawlak 1986; Kitchen and Dalton 1990; Kitchen 1992; Apinunmahakul and Devlin 2004; Canada, Department of Finance 2016; and Hickey, Minaker, Roberts, Payne, and Smith 2017).

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About the Macdonald-Laurier Institute

What Do We Do?

When you change how people think, you change what they want and how they act. That is why thought leadership is essential in every field. At MLI, we strip away the complexity that makes policy issues unintelligible and present them in a way that leads to action, to better quality policy decisions, to more effective government, and to a more focused pursuit of the national interest of all Canadians. MLI is the only non-partisan, independent national public policy think tank based in Ottawa that focuses on the full range of issues that fall under the jurisdiction of the federal government.

What Is in a Name?

The Macdonald-Laurier Institute exists not merely to burnish the splendid legacy of two towering figures in Canadian history – Sir John A. Macdonald and Sir Wilfrid Laurier – but to renew that legacy. A Tory and a Grit, an English speaker and a French speaker – these two men represent the very best of Canada's fine political tradition. As prime minister, each championed the values that led to Canada assuming her place as one of the world's leading democracies. We will continue to vigorously uphold these values, the cornerstones of our nation.


SIR JOHN A. MACDONALD


SIR WILFRID LAURIER

Working for a Better Canada

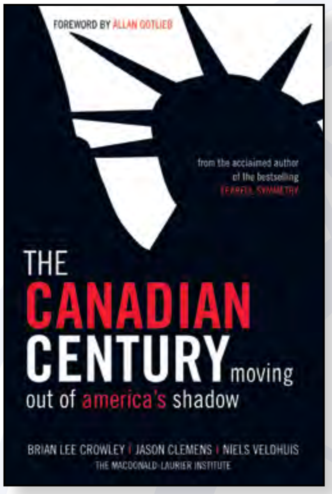
Good policy doesn't just happen; it requires good ideas, hard work, and being in the right place at the right time. In other words, it requires MLI. We pride ourselves on independence, and accept no funding from the government for our research. If you value our work and if you believe in the possibility of a better Canada, consider making a tax-deductible donation. The Macdonald-Laurier Institute is a registered charity.

Our Issues

The Institute undertakes an impressive program of thought leadership on public policy. Some of the issues we have tackled recently include:

- Aboriginal people and the management of our natural resources;
- Making Canada's justice system more fair and efficient;
- Defending Canada's innovators and creators;
- Controlling government debt at all levels;
- Advancing Canada's interests abroad;
- Ottawa's regulation of foreign investment; and
- How to fix Canadian health care.

Macdonald-Laurier Institute Publications



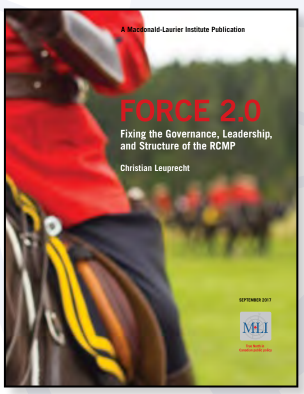
Winner of the Sir Antony Fisher International Memorial Award BEST THINK TANK BOOK IN 2011, as awarded by the Atlas Economic Research Foundation.

The Canadian Century
By Brian Lee Crowley,
Jason Clemens, and Niels Veldhuis

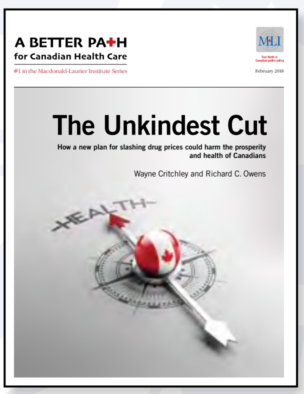
Do you want to be first to hear about new policy initiatives? Get the inside scoop on upcoming events?

Visit our website www.MacdonaldLaurier.ca and sign up for our newsletter.

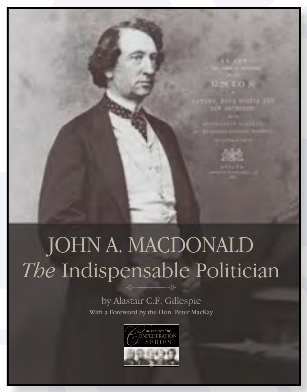
RESEARCH PAPERS



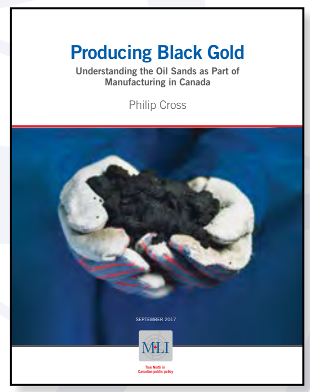
Force 2.0
Christian Leuprecht



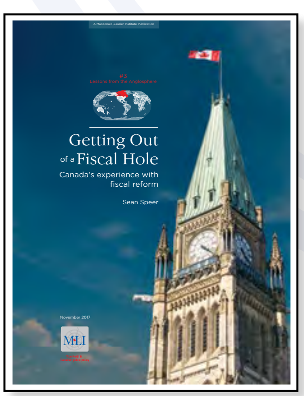
The Unkindest Cut
Wayne Critchley and
Richard C. Owens



John A. Macdonald: The Indispensable Politician
Alastair C.F. Gillespie

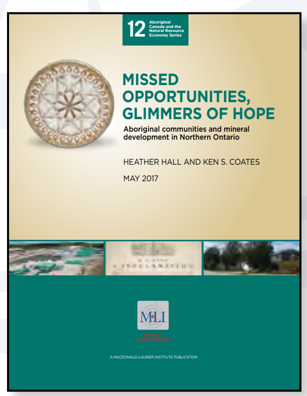


Producing Black Gold
Philip Cross



Getting Out of a Fiscal Hole
Sean Speer

Getting the Big Picture
Bram Noble



Missed Opportunities, Glimmers of Hope
Heather Hall and
Ken S. Coates

Running Out of Time
Brian Ferguson, Sean Speer,
and Ariel Freeman-Fawcett

True North in
Canadian public policy

CONTACT US: Macdonald-Laurier Institute
323 Chapel Street, Suite #300
Ottawa, Ontario, Canada
K1N 7Z2

TELEPHONE: (613) 482-8327

WEBSITE: www.MacdonaldLaurier.ca

CONNECT WITH US:

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What people are saying about the Macdonald-Laurier Institute

In five short years, the institute has established itself as a steady source of high-quality research and thoughtful policy analysis here in our nation's capital. Inspired by Canada's deep-rooted intellectual tradition of ordered liberty – as exemplified by Macdonald and Laurier – the institute is making unique contributions to federal public policy and discourse. Please accept my best wishes for a memorable anniversary celebration and continued success.

THE RIGHT HONOURABLE STEPHEN HARPER

The Macdonald-Laurier Institute is an important source of fact and opinion for so many, including me. Everything they tackle is accomplished in great depth and furthers the public policy debate in Canada. Happy Anniversary, this is but the beginning.

THE RIGHT HONOURABLE PAUL MARTIN

In its mere five years of existence, the Macdonald-Laurier Institute, under the erudite Brian Lee Crowley's vibrant leadership, has, through its various publications and public events, forged a reputation for brilliance and originality in areas of vital concern to Canadians: from all aspects of the economy to health care reform, aboriginal affairs, justice, and national security.

BARBARA KAY, NATIONAL POST COLUMNIST

Intelligent and informed debate contributes to a stronger, healthier and more competitive Canadian society. In five short years the Macdonald-Laurier Institute has emerged as a significant and respected voice in the shaping of public policy. On a wide range of issues important to our country's future, Brian Lee Crowley and his team are making a difference.

JOHN MANLEY, CEO COUNCIL